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ARTICLES

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Robert G. Boehmer*

I. Competing Demands Placed on Lenders by Regulatory Structure

A. Environmental Responsibility and Community Reinvestment

Lending institutions in the U.S. struggle continually to meet the demands of a complex and confusing regulatory structure.[1] In some cases, clashes between the laws comprising this regulatory structure create a "Catch 22" situation for the regulated institutions and interfere with accomplishment of the goals of the regulatory structure. On one hand, for example, the Superfund statute[2] seeks to encourage

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1. Banking leaders claimed, in recent testimony before the Federal Financial Institutions Council, that U.S. banks are "choking in a maze of regulatory red tape." *Banks Say Compliance With CRA, Other Laws Hurts Lending; Consumers Disagree*, BNA'S BANKING REP., June 29, 1992, at 1128. The American Bankers Association recently surveyed 10,000 banks and received over 1,000 responses. The American Bankers Association has admitted that the survey is not scientific. However, the survey led the American Bankers Association to conclude that the banking industry spent over $10.7 billion dollars in 1991 to comply with rules and regulations. This represents 59 percent of profits. This compliance cost estimate does not include the costs of complying with the provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 and does not include FDIC premiums paid by the banks. Rehm, *Cost of Compliance Equals 59% of Bank Profits*, AM. BANKER, June 18, 1992, at 1; and *Banks Spent $10.7 in Compliance Costs in 1991, an ABA Survey Estimates*, BNA'S BANKING REP., June 22, 1992, at 1086.

2. Comprehensive Environmental Response, Compensation, and Liability Act of 1980,

environmentally responsible lending[3] by imposing liability for hazardous waste cleanup upon lenders whose loans are secured by a contaminated site.[4] On the other hand, the Community Reinvestment Act[5] requires most federally supervised lending institutions to adopt and implement plans designed to meet their communities' needs for capital for maintenance and revitalization.[6] These goals clash when the lender finds it necessary to decline an opportunity to lend because of the possibility that the lender may, at some point in the future, be held liable under CERCLA for the cost of cleaning up hazardous substance spills upon the property which would have secured its loan.[7]

Pub. L. No. 96-510, 94 Stat. 2767, as amended by the Superfund Amendments and Reauthorization Act of 1986, Pub. L. No. 99-499, § 101(35), 100 Stat. 1613 (codified as amended at 42 U.S.C. §§ 9601-9675 (1988)) [hereinafter CERCLA]. CERCLA is frequently referred to as the Superfund law. *E.g.*, Bruce P. Howard and Melissa K. Gerard, *Lender Liability Under CERCLA: Sorting Out the Mixed Signals*, 64 S. CAL. L. REV. 1187, 1188 (1991).

3. It is clear that Congress intended, through the enactment of CERCLA, to create a strict liability structure both to encourage the safe handling and efficient cleanup of hazardous substances and to create a funding source for the cost of cleanup. *See generally* Senate Committee on Envt. and Public Works, 97th Cong., 2d Sess., A Legislative History of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (Comm. Print 1983, 3 vols.). However, the intended treatment of secured lenders within this broad strict liability structure simply remains uncertain. As stated recently by the EPA in connection with the publication of a final rule defining the scope of the security interest exemption, "The scant legislative history of the security interest exemption does not shed much light on this issue." 57 Fed. Reg. 18,344, 18,345 (1992). This same conclusion has been reached repeatedly by various commentators. *E.g.*, Murphy, *The Impact of "Superfund" and Other Environmental Statutes on Commercial Lending on Investment Activities*, 41 BUS. LAW. 1133, 1139 (1986) (the legislative history provides "no real guidance" on the issue); and Note, *Cleanup the Debris After Fleet Factors: Lender Liability and CERCLA's Security Interest Exemption*, 104 HARV. L. REV. 1249 (1991) (the legislative history provides "little insight into this definitional ambiguity"). Accordingly, it is best at this point to simply accept the uncertainty and to proceed legislatively to correct that uncertainty. *See infra* note 276. Although the intent of Congress concerning the treatment of secured lenders within this strict liability structure is uncertain, the provisions of the Innocent Landowner Defense (discussed *infra* at note 66) clearly are intended to encourage environmentally responsible lending. *See generally* STAFF OF SENATE COMMITTEE ON ENVT. AND PUBLIC WORKS, A LEGISLATIVE HISTORY OF THE SUPERFUND AMENDMENTS AND REAUTHORIZATION ACT OF 1986 (Comm. Print 1990, 7 vols.).

4. *See infra* notes 24-69 and accompanying text.

5. Community Reinvestment Act of 1977, 12 U.S.C. §§ 2901-2906 (1988) (requiring federally supervised financial banks and savings and loan associations to adopt written plans specifying action intended to meet the credit needs of the low and moderate income areas of their local communities and permitting federal regulators to take action, such as the denial of branching applications, based on a substandard record of meeting those credit needs).

6. *Id.*

7. Over 88% of 1,700 banks recently surveyed by the American Bankers Association have changed lending procedures to avoid environmental liability. Over 45% have discontinued financing certain types of transactions. Over 60% have rejected applications because of the exposure potential. O'Brien and Nooney, *EPA's Lender Liability Rule: A Significant Step for the Lending Community*, TOXICS L. REP., July 24, 1991, at 246. *See also*, Grady, *Steering Clear of Pollution Risk*, AM. BANKER, Jan. 22, 1992, at 4 (reporting on that same survey); and *Lender Liability Playing a Significant Role in Credit Crunch, ABA Official Says*, BNA

B. *Illustrative Hypothetical*

Put yourself, for a moment, in the shoes of a typical community banker in the U.S. On many days you handle, among other things, consumer loans files, business loan files, human resource problems and various community responsibilities. You likely find the vast array of laws regulating your day-to-day activities to be overwhelming. At best, you are probably able to manage a general familiarity with the basic messages conveyed by each of these laws. This general familiarity likely causes you, in many cases, to simply avoid a proposed activity when you encounter a legal danger signal rather than prompting you to spend the time and money to analyze the legal aspects of the problem in depth.

As an example, assume that a customer applies for a secured loan to acquire a building in a moderate income area of your community. The prospective borrower wants to open up a dry cleaning establishment at a location which was used by the prior owner to manufacture paint. You want to make the loan. It is a solid business proposition, the customer has a good credit history and the loan will further your goals concerning investment in low to moderate income areas of your community.

Assuming away blissful ignorance of the law, the messages sent to you by federal law in this case probably support, at first blush, your desire to make the loan. The loan will likely bolster your Community Reinvestment Act record. However, CERCLA likely conveys different messages to you. Both the prior use of the property[8] and its proposed use[9] are legal danger signals giving you concern about the liability exposure of your institution under CERCLA. How might you react?

A first possibility is that the prior or proposed use of the property will simply force you decline the loan based on your institution's internal policy.[10] If your internal policy does not foreclose the possibility of extending credit in this situation, it is likely that you will seek to minimize risk by requiring a clean environmental audit as a condition to making the loan.[11] If that audit discloses problems, the

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BANKING DAILY, Oct. 17, 1991 (reporting that the chief economist for the American Bankers Association identified the fear of environmental liability as an "important factor" contributing to the credit crunch).

8. *See infra* note 44 and accompanying text.

9. *See infra* note 42 and accompanying text.

10. O'Brien and Nooney, *supra* note 7.

11. *E.g.*, Schnapf, *How to Conduct an Environmental Due Diligence Investigation*, COM. LENDING REV., at 29.

likely result is, again, a denial of the application.[12] If an existing environmental problem is not revealed by the audit, the proposed use of the property will likely induce you to carefully tailor your loan documentation[13] in order to minimize liability should your customer later be involved in a spill of hazardous substance on the property.

If you, as the lender, proceed as described above, have the goals of the Superfund law been advanced? In a limited sense, possibly yes. The environmental audit encourages identification of hazardous waste sites. Also, the obligations placed upon the borrower by the enhanced documentation may encourage environmentally responsible behavior. In the broader view, the answer is probably no. It is certainly hard to see how encouraging responsible lenders to avoid environmentally sensitive loans makes a dent in the serious natural problem involving the clean-up of toxic dump sites. Similarly, the manner in which the courts have applied the provisions of CERCLA to secured lenders[14] encourages them to take a less active role in the monitoring of their borrower's activities. This likely negates many of the beneficial results of the enhanced loan documentation.[15]

What is the net result in this hypothetical situation? First, the goals of the Community Reinvestment Act have been thwarted. Second, the goals of CERCLA may have been advanced, but only insignificantly.

II. Scope of this Article

This article addresses the quandary facing secured lenders illustrated by the above hypothetical. The article first describes the provisions of CERCLA relevant to an analysis of the liability exposure of secured lenders. A key provision of CERCLA exempts secured lenders from CERCLA liability when the lenders' degree of involvement with the management of the borrower's business remains beneath a certain threshold level. This exemption is commonly known as the Security Interest Exemption.[16]

The Security Interest Exemption has spawned a series of federal cases[17] construing the scope of that exemption. Unfortunately, those

12. O'Brien and Nooney, *supra* note 7.
13. *See infra* note 23.
14. *See infra* notes 70-150.
15. *But see* States, *Pollution Solutions for Banks*, BANKERS MONTHLY, Jan. 1992, at 27 (reporting on a bank using a procedure called bioremediation to introduced microbes into contaminated sites to clean the sites).
16. 42 U.S.C. §9601(2)(A) (1988). *See infra* notes 48-49.
17. *See infra* notes 70 to 150.

cases have created massive uncertainty about the scope of the Security Interest Exemption.[18] Accordingly, the article next presents a chronological description and analysis of these judicial interpretations of the Security Interest Exemption to demonstrate both the broad nature of the secured lender's liability potential, as well as the conflicting and continually changing messages delivered to lenders by these cases.

The furor in the lending community[19] set off by these court decisions prompted the Environmental Protection Agency (EPA) to begin work in 1990 on an administrative rule construing the Security Interest Exemption[20] and to publish a proposed rule in 1991. Additionally, several proposals for federal legislation to address that issue were seriously debated during 1991.[21] None of those legislative proposals have become law but the EPA did publish its administrative rule in final form (the Final EPA Rule) in early 1992.[22]

This article focuses on the Final EPA rule. The rule is first described in detail. Its provisions are then compared to an earlier proposed version of the rule in order to demonstrate potential weaknesses in the rule. The article argues that while the Final EPA Rule has solved some problems for lenders, a few gaping holes in its coverage remain. To conclude the article, an argument for a legislative solution is presented.

It is beyond the scope of this article to present a complete discussion of the various means being used by financial institutions to avoid CERCLA liability.[23] However, the practices spawned by the

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18. *Compare* the case discussed at *infra* notes 126-41 with the case discussed at *infra* notes 142-50 for an example of this uncertainty.

19. *E.g.*, Brian W. Smith, *Cleanup Law Hazardous to Banks With Deep Pockets*, AM. BANKER, July 18, 1990, at 4. *See infra* note 151. *But see* Stephen Kleege, *Lenders Doubt Report That Belittles Cleanup Liability*, AM. BANKER, Apr. 2, 1991, at 6 (noting that some experts believe that the liability exposure has been exaggerated).

20. *See infra* notes 152-54.

21. *See infra* notes 238-75.

22. *See infra* note 155.

23. *See generally* Stephen Kleege, *Clean Lending*, AM. BANKER, Apr. 27, 1992, at 2A (reporting on availability of insurance at a cost of approximately 1% of a typical million dollar loan to cover environmental exposure but reporting that the process to obtain the insurance may take nine months); Grady, *Steering Clear of Pollution Risk*, AM. BANKER, Jan. 22, 1992, at 4 (emphasizing the importance of a written policy of environmental risk management adopted by the board of directors); Slater, *Pollution Solutions For Bankers*, BANKERS MONTHLY, Jan. 1992, at 27 (reporting on bank access to databases maintained by companies in the business of collecting information on environmentally sensitive sites); Howard and Gerard, *supra* note 2 at 1217-18; Kleege, *Lenders Seeking Ways to East Pain of Cleanup Liability*, AM. BANKER, Dec. 10, 1991, at 12 (reporting on a company which is in the business of providing computer searches of land records for evidence of contamination); Kleege, *Growing Cadre of Experts Leads Bank Past Cleanup Traps*, AM. BANKER, Sept. 10, 1991, at 11 (reporting on the trend toward the hiring of environmental review specialists by banks); Schnapf,

uncertainty surrounding the Security Interest Exemption, rather than furthering the goals of CERCLA, foster paperwork rather than positive solutions. Accordingly, these practices are discussed in various portions of the article in order to demonstrate this aspect of the problem.

III. Statutory Provisions Creating Superfund Liability Potential for Lenders

A lender must evaluate its CERCLA liability potential in connection with virtually every secured loan because of the broad brush approach taken by CERCLA to impose liability for hazardous waste cleanup. A secured lender is liable under CERCLA any time a release or a threatened release of a hazardous substance takes place causing response costs to be incurred[24] and the lender falls within

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supra note 11; Stephen Kleege, *Some Tips on Assessing Environmental Risk*, AM. BANKER, Oct. 30, 1990, at 10 (reporting views of environmental law lawyer who recommends guarantees of borrower's compliance with environmental laws, indemnifications by borrowers, insurance against environmental hazards site inspections and avoiding entanglement with management of borrower's business) Beutelschies, *Lenders Can Avoid Liability For Cleaning Up Waste Sites*, AM. BANKER, Oct. 24, 1990, at 4 (reporting on use of pre-loan environmental questionnaires, environmental audits, environmental covenants, warranties and indemnities, contractual property use restrictions and contractual notification provisions concerning the occurrence of certain events such as hazardous substance spills); Gebhardt, *The Environmental Inspection Easement: An Essential Commercial Loan Document*, BANKING L.J., July-Aug. 1990, at 317 (giving the lender the access to borrower's property to assess environmental liability upon the occurrence of a default); Charles E. Davidson, *Environmental Considerations in Loan Documentation*, BANKING L.J. July-Aug. 1989, at 308 (emphasizing the importance of a pre-loan environmental questionnaire); Rowley and Witmer, *Assessing Environmental Risks in Booking a Loan*, COM. LENDING REV., Winter 1988-89, at 53 (stressing the importance of written representations by borrowers concerning compliance with various environmental laws, encouraging the use of environmental auditing and suggesting that the use of provisions such as borrower indemnification of the lender, and waiver of jury trial provisions be considered when documenting the loan).

Perhaps more importantly, lenders should consider requiring insurance which specifically insures against this type of risk at the time of making the loan. *See generally*, Olsen, *Pollution Predicament*, INSTITUTIONAL INVESTOR, Aug. 1991, at 6; Krauss, *Finding Pollution Liability Insurance Is No Easy Task*, INVESTOR'S DAILY, Aug. 14, 1991, at 8; Kleege *Cleanup Insurance Draws Interest; Colorado Engineering Firm Branches Out to Offer Policy*, AM. BANKER, July 23, 1991, at 8. Court decisions have not been uniform in addressing the issue of insurer liability for pollution clean-up under comprehensive general-liability policies. *Environmental Cleanup Is a National Problem, But Superfund Provisions Threaten to Dump the Burden on Reinsurers*, INSTITUTIONAL INVESTOR Sept. 1991, at 143. Eugene R. Anderson and Jordan Stanzler, *Maybe You're Not Really Naked*, ABA BANKING J., Aug. 1991, at 24; and Rice, *Business and the Environment; Discovery of Lost Insurance*, FINANCIAL TIMES, May 29, 1991 at 16. *But see* Hathaway, *Borrowers Should Examine Pollution Insurance to Ensure That Coverage Is Worth the Cost*, MORTGAGE MARKETPLACE, June 29, 1992, at 2.

24. 42 U.S.C. § 9607(a) (1988). Note that CERCLA is not the only possible statutory basis for liability of a secured lender in the cases of environmental cleanup. Other state and federal statutes must be considered. *See, e.g.*, Brooks J. Bowen, *Liability for LUSTs is an Exercise in Confusion*, A.B.A. BANKING J., June 1991, at 28; Kass and Gerrard, *Lender Liability for Water Pollution*, N.Y. L.J., Feb. 20, 1991, at 3. Additionally, lenders must now consider the possibility that they will be held liable upon a theory of aiding and abetting

one (or more) of the categories of responsible parties established by CERCLA (Responsible Parties).[25] The federal government may recover the costs and damages specified by CERCLA in a civil action against responsible parties.[26] Similarly, a private party may do so.[27]

A. What is a release or a threatened release of a hazardous substance?

When a secured lender is evaluating its CERCLA liability potential, the liability triggering events that concern the lender are both "releases"[28] and "threatened releases"[29] of hazardous sub-

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pollution. O'Neill v. Q.L.C.R.I., 750 F. Supp. 551 (D.C. Rhode Island 1990). *See generally* Voorhees and Steele, *Birth of a New Lender Liability Theory? Aiding and Abetting a Borrower's Violation of Environmental Laws*, TOXICS L. RPTR., Jan. 8, 1992, at 950 (analyzing the above Rhode Island case); *Aiding and Abetting Pollution Case Nightmare for Lenders, Attorney Says*, BNA'S BANKING REPORT, Oct. 21, 1991, at 666 (reporting that the above Rhode Island case creates a new theory of lender liability because it is the first reported decision allowing an aiding and abetting claim against a lender in an environmental case).

25. 42 U.S.C § 9607(a)(1)-(4) (1988). *See infra* notes 37-50. *See generally* Barr, *CERCLA Made Simple: An Analysis of Cases Under the Comprehensive Environmental Response, Compensation and Liability Act of 1980*, 45 BUS. LAW. 923 (1990). A wave of articles has passed through the literature since 1986 analyzing various aspects of this liability potential. *See generally* Note, *Cleaning Up the Debris After Fleet Factors: Lender Liability and CERCLA's Security Interest Exemption*, 104 HARV. L. REV. 1249 (1991); Howard and Gerard, *supra* note 2; Burcat, Shorey, Chadwell and O'Connell, *The Law of Environmental Lenders Liability*, 21 E.L.R. 10464 (1991); Fogarty, *The Legal Case Against Lender Liability*, 21 E.L.R. 10243 (1991); Blinn, *An Obstacle Course for 'Fleet'-Footed Lenders; Whose Responsibility is Environmental Cleanup?*, TEX. LAW., Mar. 11, 1991, at 28; David R. Berz and Peter M. Gillon, *Lender Liability Under CERCLA: In Search of a New Deep Pocket*, BANKING L.J., Jan.-Feb. 1991, at 4; Freeman and Guizar, *Fleet Factors Update: Participation in Management*, COM. LENDING REV., Win. 1990-91, at 41; Stanley M. Spracker and James D. Barnette, *Lender Liability Under CERCLA*, 1990 COLUM. BUS. L. REV. 527 (1990); Sharon E. Jaffe and Lisa A. Schoolman, *Hazardous-Waste Legislation Affecting Lender Liability*, BANKING L.J., Sept.-Oct. 1990, at 422; Simons, *Issues in Lending. . .Lender's Exemption for Environmental Cleanup and the Fleet Factors Case*, J. OF COM. BANK LENDING, Sept. 1990, at 26; Brown, *Fleet Factors Case Produces Gibberish*, ILL. LEGAL TIMES, Aug. 1990, at 29; Brian W. Smith, *Cleanup Law Hazardous to Banks With Deep Pockets*, AM. BANKER, July 18, 1990, a 4; Roslyn Tom, *Interpreting the Meaning of Lender Participation in Management Under Section 101(20)(A) of CERCLA*, 98 YALE L.J. 925 (1989); Susan M. King, *Lenders' Liability For Cleanup Costs*, 18 ENVTL. L. 241 (1988); Patricia L. Quentel, *The Liability of Financial Institutions for Hazardous Waste Cleanup Costs Under CERCLA*, 1988 WIS. L. REV. 139; Scott WIlson, Note, *When Security Becomes a Liability: Claims Against Lenders in Hazardous Waste Cleanup*, 38 HASTINGS L.J. 1261 (1987); Elizabeth Ann Glass, *The Modern Snake in the Grass: An Examination of Real Estate and Commercial Liability Under Superfund and SARA and Suggested Guidelines For the Practitioner*, 14 B.C. ENVTL. AFF. L. REV. 381 (1987); Burcat, *Foreclosure and United States v. Maryland Bank & Trust Co.: Paying the Piper or Learning How to Dance to a New Tune?*, 17 E.L.R. 10098 (1987); Margaret Murphy, *The Impact of "Superfund" and Other Environmental Statutes on Commercial Lending and Investment Activities*, BUS. LAW., Aug. 1986, at 1133; Reed, *Fear of Foreclosure: United States v. Maryland Bank & Trust Co.*, 16 E.L.R. 10165 (1986).

26. 42 U.S.C. § 9607(a) (1988).

27. *E.g.*, Dedham Water Co. v. Cumberland Dairy Farms, Inc., 805 F.2d 1074, 1078 (1st Cir. 1986).

28. 42 U.S.C. § 9607(a)(4) (1988). *See id.* § 9601(22) (1988) for definition of "release."

stances. Again, the broad definitions given by CERCLA to "release" and "hazardous substance," heighten the secured lender's concern.

"Hazardous substance,"[30] as used in CERCLA, refers to a wide range of dangerous substances. For example, the solvents used in dry cleaning operations would normally fall within the scope of the definition. However, that definition expressly excludes most "petroleum, including crude oil" as well as "natural gas, natural gas liquids, liquefied natural gas, or synthetic gas usable for fuel (or mixtures of natural gas and such synthetic gas)."[31]

Similarly, the term "release" is broadly defined by CERCLA to mean, with certain exceptions, "any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping or disposing into the environment (including the abandonment or discarding of barrels, containers or closed receptacles containing any hazardous substance or pollutant or contaminant)."[32] Therefore, a "release" would include the intentional disposal by the borrower of a hazardous substance on its property as well as an accidental spill. However, it is not only an actual release which creates liability potential. A "threatened release" creates the same type of exposure.[33]

B. What is a response cost?

A specific causal connection must, however, be established in order for CERCLA liability to be imposed on a Responsible Party. The required causal connection is between the release (or threatened release) and the necessity of incurring "response" costs.[34] CERCLA defines "response"[35] to mean all action to remove and remedy the release or threatened release, including any related enforcement action.[36] It is the threat of being required to pay these response costs that causes many lenders to back away from otherwise viable loans.

29. *Id.* § 9607(a)(4). "Threatened release" is not a defined term under CERCLA.

30. *Id.* § 9601(14). This definition of "hazardous substance" makes reference to substances listed both in other federal environmental statutes and in other provisions of CERCLA.

31. *Id.*

32. *Id.* § 9601(22).

33. 42 U.S.C. § 9607(a)(4) (1988).

34. *Id.* The manner in which this causation requirement of the statute is printed has caused some confusion. The causation requirement is printed in a way that appears to make it modify only the provisions of subsection (4) of section 9607 of title 42. However, it has been interpreted to apply to subsections (1) through (4) inclusive. *E.g.*, Dedham Water Co. v. Cumberland Farms Dairy, Inc., 889 F.2d 1146, 1151 n.4 (1st Cir. 1989).

35. 42 U.S.C. § 9601(25) (1988).

36. *Id. See* 42 U.S.C. § 9601(24) for the definition of "remedy" and "remedial action" and *id.* § 9601(23) for the definition of "remove" and "removal."

C. *Who is responsible for response costs?*

If the release or threatened release occurs and causes response costs to be incurred, then CERCLA establishes four categories of Responsible Parties.[37] If a person[38] is a Responsible Party, then CERCLA imposes strict liability[39] "without regard for causation."[40] If there is more that one Responsible Party, then all Responsible Parties are jointly and severally liable under CERCLA[41] for any indivisible environmental harm. These four categories of Responsible Parties are:

> 1. Current owners and operators of the contaminated property[42] (Current Owners); and
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> 2. Owners or[43] operators of the contaminated property at the time of disposal[44] (Former Owners); and
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> 3. Those who arrange for disposal, treatment or transport of hazardous substance[45] (Arrangers); and
>
> 4. Those who accept hazardous substance for transport[46] (Transporters).

The primary source of CERCLA liability for secured lenders arises from the possibility of being categorized as a Current Owner or Former Owner of the contaminated property. Liability as an Arranger or Transporter is, also, possible but far less likely as a practical matter.

Liability as a Current Owner or Former Owner arises from the broad meaning given to that phrase by CERCLA. "Owner or operator", in the case of a facility, is defined by CERCLA in a circular fashion to mean "any person owning or operating such facility."[47]

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37. *Id.* § 9607(a)(1)-(4).
38. *Id.* § 9601(21) (defining "person" broadly to include individuals and entities).
39. *E.g.*, United States v. Monsanto, 858 F.2d 160, 167 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 3156 (1989).
40. *E.g.*, United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 576 (D. Md. 1986).
41. *E.g.*, United States v. Chem-Dyne Corp., 572 F. Supp 802, 810-11 (S.D. Ohio 1983).
42. 42 U.S.C. § 9607(a)(1) (1988). A Current Owner is liable even if the hazardous waste contamination of the facility occurred prior to that Current Owner's acquisition of an indicia of ownership in the facility. *E.g.*, United States v. Argent Corp., 21 Env't Rep. Cas. (BNA) 1354 (1984).
43. In the case of Current Owners, CERCLA refers to liability if the person is an owner "and" an operator. In contrast, in the case of Former Owners, CERCLA refers to liability when the person is an owner "or" an operator. This has been construed to be inadvertent drafting error. *See infra* notes 105-107.
44. 42 U.S.C. § 9607(a)(2) (1988).
45. *Id.* § 9607(a)(3).
46. *Id.* § 9607(a)(4).
47. *Id.* § 9601(20)(A)(ii).

Therefore, under applicable state law, a secured lender holding any "indicia of ownership" in the property securing its loan is potentially a Responsible Party as either a Current Owner or a Former Owner.

It is at this juncture that the critical issue arises. The CERCLA definition of "owner or operator" specifically excludes, "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility."[48] This exemption is generally referred to as the "Security Interest Exemption."[49] It is the uncertainty concerning the scope of this exemption which has befuddled lenders, the EPA and the courts.

Liability as a Current Owner or Former Owner of the contaminated property may attach, not only when the lender holds a security interest in real property, but in connection with security interests in personal property as well. This occurs because CERCLA requires only that the ownership interest be held in a "facility" in order for the lender to be classified as a Responsible Party. A "facility"[50] is broadly defined as "(A) any building, structure, installation, equipment, pipe or pipeline (including any pipe into a sewer or publicly owned treatment works), well, pit, pond, lagoon, impoundment, ditch, landfill, storage container, motor vehicle, rolling stock or aircraft, or (B) any site or area where a hazardous substance has been deposited, stored, disposed of or placed, or otherwise come to be located; but does not include any consumer product in consumer use of any vessel."

D. What costs and damages are potentially recoverable?

If liability is imposed by CERCLA upon a secured lender, the scope of the costs and damages for which that lender may be held liable is imposing. That liability includes responsibility to pay all of the following:

1. All costs of removal or remedial action"[51] by the govern-

48. *Id.* § 9601(20)(A) (emphasis added).

49. This is the terminology used by the EPA to refer to this exemption from the "owner or operator" definition. 57 Fed.Reg. 18,344, 18,345 (1992).

50. 42 U.S.C. § 9601(9) (1988). *See id.* § 9601(17) for the definition of "offshore facility" and *id.* § 9601(18) for the definition of " onshore facility." If title or control of a facility was conveyed to a state or local government due to bankruptcy, foreclosure, tax delinquency, abandonment or similar means, then the "owner or operator" is the person who operated or otherwise controlled the activities at that facility immediately before that conveyance. *Id.* § 9601(20)(A)(iii). *See id.* at 9601(20)(A)(i) (1988) for the definition of "owner or operator" in the case of a "vessel" and *id.* § 9601(28) for the definition of "vessel."

51. *Id.* § 9607(a)(4)(A). *See id.* § 9601(23) for the definition of "removal." *See id.* §

ment which are not inconsistent with the national contingency plan;[52]

2. Any necessary costs of response incurred by any other person consistent with the national contingency plan;[53]

3. Damages for injury to, destruction of or loss of natural resources.[54] In addition, the reasonable costs of assessing that injury, destruction or loss may be recovered.[55]

4. The costs of certain health assessment or health effects studies.[56]

All of these amounts may be recovered with interest accruing from the date and at the rate specified by CERCLA.[57]

E. Are any defenses available?

A lender, who is otherwise liable under CERCLA, may avoid liability by establishing "by a preponderance of the evidence that the release or threatened of release of a hazardous substance and the damages resulting" from that release or threatened release were solely caused by (1) an act of God;[58] (2) an act of war;[59] (3) an act or omission of a third party (Third Party Defense);[60] (4) or any combination of those reasons.[61]

The Third Party Defense is the defense of which secured lenders are most likely to avail themselves. The Third Party Defense has two separate elements. First, it requires the lender to establish that the release or threatened release were neither caused by its employee or agent nor by *one whose act or omission occurs in connection with a contractual relationship*, existing directly or indirectly, with the lender.[62] Second, the lender is required to establish by a preponderance of the evidence that it exercised due care[63] and took precautions against foreseeable acts and omissions of the third party.[64]

In the case of a secured lender seeking to establish the Third

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9601 (24) for the definition of "remedial action."

52. *Id.* § 9607(a)(4)(A). *See id.* § 9601(31) for the definition of "national contingency plan."
53. *Id.* § 9607(a)(4)(B). *See id.* § 9601(25) for the definition of "response."
54. *Id.* § 9607(a)(4)(C). *See id.* § 9601(16) for the definition of "natural resources."
55. 42 U.S.C. § 9607(a)(4)(C) (1988).
56. *Id.* § 9607(a)(4)(D).
57. *Id.* § 9607(a).
58. *Id.* § 9607(b)(1).
59. *Id.* § 9607(b)(2).
60. 42 U.S.C. § 9607(b)(3) (1988).
61. *Id.* § 9607(b)(4).
62. *Id.* § 9607(b)(3) (emphasis added).
63. *Id.* § 9607(b)(3)(a).
64. *Id.* § 9607(b)(3)(b).

Party Defense, the question is whether that lender had a "contractual relationship" with its borrower (as that term is used in CERCLA). CERCLA's definition specifically includes within the meaning of "contractual relationship" documents such as "deeds or other instruments transferring title or possession, unless the real property on which the facility concerned is located was *acquired by the defendant after the disposal or placement of the hazardous substance* on, in, or at the facility" and one of three circumstances is established.[65]

One of these three circumstances is commonly referred to as the "Innocent Landowner Defense."[66] The defense requires the secured lender to establish that, at the time of the secured lender's acquisition of its interest in the facility, the lender neither knew or had reason to know "that any hazardous substance which is the subject of the release or threatened release was disposed of on, in or at the facility."[67] CERCLA, in addition, provides subjective standards for determining whether that lack of reason to know existed. Specifically, the defendant must in order to avail itself of the defense, have "undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial practice or customary practice in an effort to minimize liability."[68] In determining whether the inquiry was, in fact, appropriate, a court is required to consider any specialized knowledge of the defendant, the relationship of the purchase price of the property to its value if uncontaminated, information which is commonly known or readily ascertainable, the degree of obviousness of the presence or likely presence of contamination and the ability to detect that contamination by inspection.[69] Because of the specialized knowledge possessed by most institutional lenders, the type of pre-loan inquiry necessary for institutional lenders to successfully establish this defense is much higher than for those not in the business of regularly extending loans.

The Innocent Landowner Defense might be available, for example, to a lender when the property securing the loan was contaminated prior to the lender acquiring its security interest. If the lender is now unable to successfully establish the Security Interest Exemp-

65. 42 U.S.C. § 9601(35)(A) (1988) (emphasis added).
66. 57 Reg. Reg. 18,344, 18,353 (1992). This is the term used by the EPA to refer to this defense.
67. 42 U.S.C. § 9601(35)(A)(i) (1988).
68. *Id.* § 9601(35)(B).
69. *Id.*

tion (*E.g.*, the lender participated in the management of its borrower) but is able to establish that it required an appropriate environmental audit of the property prior to acquiring its security interest and the audit failed to disclose the fact that contamination or the threat of contamination then existed, the defense may apply. In contrast, the Innocent Landowner Defense would not apply if the "disposal or placement of the hazardous substance on, in, or at the facility" occurred after the lender acquired its interest in the property. In that case, a lender would need to establish the existence of the Security Interest Exemption (or one of the other defenses) in order to avoid liability.

IV. Judicial Interpretations of the Security Interest Exemption

The scope of the Security Interest Exemption has been addressed to date in only seven reported decisions.[70] Two of the decisions have been at the appellate level.[71] Those two decisions have taken contrasting approaches and the U.S. Supreme Court has declined to reconcile the differences.[72] The following section chronologically traces the development of this case law from 1985 to the present.

A. T.P. Long[73]

This case involved a dispute over funds held by a trustee in bankruptcy. The debtor corporation (T.P. Long) previously operated a rubber recycling plant upon real property (the site) owned by T.P. Long's sole shareholder and his wife. T.P. Long filed a chapter 11 reorganization petition, the case was converted to a chapter 7 proceeding and a trustee was appointed. While the bankruptcy proceeding was still pending, some of the assets of the bankruptcy estate were sold to a purchaser (Tompkins). One of the assets Tompkins purchased was a tank containing a hazardous substance. In what the court characterized as an "act of vandalism,"[74] some of the hazardous substance was released onto the site before Tompkins removed the tank. Additionally, drums containing the hazardous substance were buried on the site. After the trustee declined to take remedial action, the EPA cleaned up the site at a cost in excess of $37,000.

70. *See infra* notes 73 to 150.
71. *See infra* notes 126 and 142.
72. *See infra* note 126.
73. In re T.P. Long Chem, Inc., 45 Bankr. 278 (Bankr. N.D. Ohio 1985).
74. *Id.* at 279.

The EPA then filed an application to be reimbursed from the bankruptcy estate for these response costs. The application was opposed by the trustee and BancOhio. BancOhio was the owner of a perfected security interest in various items of personal property and proceeds of the debtor, including the buried drums. After ruling that the bankruptcy estate was liable under CERCLA for the clean-up costs[75] and, therefore, entitled to pay those amounts as priority expenses,[76] the court considered the status of BancOhio.

Unencumbered assets of the estate were insufficient to pay the clean-up costs. As a result, the EPA sought payment out of funds subject to BancOhio's security interest and held by the trustee. In reaching its decision to deny the EPA's application,[77] the court rejected the EPA's argument that BancOhio was liable under CERCLA for removal costs. The court reasoned:

> The court finds that *even if BancOhio had repossessed its collateral pursuant to its security agreement* it would not be an "owner or operator" as defined under CERCLA . . . . The only possible indicia of ownership that can be attributed to BancOhio is that which is primarily to protect its security interest. It is undisputed that BancOhio has not participated in the management of the Long facility. Thus, BancOhio cannot be held liable as an owner or operator under CERCLA.[78]

Accordingly, *T. P. Long* provided an early signal to lenders that creditors would be entitled to the benefit of the Security Interest Exemption even following the lender's acquisition of legal title through foreclosure or repossession.

B. Mirabile[79]

The next reported decision was rendered when the United States brought a civil action under CERCLA to recover the costs of removing allegedly hazardous waste from a parcel of real estate (the site), which was formerly the location of a paint manufacturing business. The defendants were the individual owners of the site at the time the action was filed, Anna and Thomas Mirabile (the Mirabiles). The Mirabiles impleaded two financial institutions, American Bank and Trust Company (American) and Mellon Bank

75. *Id.* at 284.
76. *Id.* at 286.
77. *Id.* at 289.
78. In re T.P. Long Chem., Inc., at 288-89 (emphasis added).
79. United States v. Mirabile, 15 Envtl. L. Rep. 20,994 (E.D. Pa. 1985).

(Mellon). American and Mellon then filed counterclaims against the plaintiff based on allegations of the involvement of the Small Business Administration (SBA). The issues, characterized by the court as issues of "first impression",[80] revolved around the circumstances under which CERCLA liability may be imposed on a person who provides financing to the owner or operator of a hazardous waste dump site.[81]

American was the first lender to become involved in this paint manufacturing operation. It loaned money to a corporation which operated a paint manufacturing facility on the site. The loan was secured by a mortgage on the site. Subsequently, ninety-five percent of the stock of American's borrower was acquired by another corporation (Turco). Turco's operations on the site were the cause of the allegedly hazardous spill.

Mellon's predecessor in interest (Girard Bank) then became involved. A working capital loan was made to Turco secured by Turco's inventory and assets. When Turco later established an advisory board, one of Girard Bank's officers became a member of that board. A second officer of the same lender later replaced the first officer on the advisory board.

The SBA next became involved in Turco's financing. The SBA loan to Turco was secured by a second lien on the debtor's machinery and equipment, a second lien on the debtor's inventory and accounts receivable, a second lien on the site, and a stock pledge. SBA regulations at that time required the SBA to provide management assistance to its borrowers and the SBA was granted the power by the loan agreement to approve in advance any of Turco's management assistance contracts.

Ultimately, Turco filed a chapter 11 bankruptcy petition, which was later dismissed. The court was then required to evaluate the CERCLA liability of the three above-discussed lenders separately.

American had foreclosed its mortgage on the site. It purchased the property at the foreclosure sale, informed the county sheriff of intent to take title, but assigned its interest in the site to a purchaser before the sheriff's foreclosure deed was delivered. The deed was then delivered to that purchaser by the sheriff. After the foreclosure sale, American took steps to protect a building on the site from vandalism, inquired about the cost of cleaning up hazardous waste and showed the property to potential buyers. All of these activities took

80. *Id.* at 20,995.
81. *Id.*

place in a period of several months following the sale. The court granted American's motion for summary judgment.[82] In reaching this decision, the court declined to decide, under Pennsylvania law, whether American had ever acquired legal title.[83] It reasoned that a decision was unnecessary because all of American's actions, including foreclosure and purchase at the foreclosure sale, were undertaken to protect its security interest.[84] The court ruled that American's actions did not cause it to be liable under CERCLA. Instead, the court adopted a day-to-day management test stating:

> Thus, it would appear that before a secured creditor such as ABT may be held liable. it *must, at a minimum, participate in the day-to-day operational aspects of the site.* In the instant case, ABT merely foreclosed on the property after all operations had ceased and thereafter took prudent and routine steps to secure the property against further depreciation.[85]

In Mellon's case an officer of Mellon was on Turco's advisory board prior to Turco's bankruptcy filing. Another officer of Mellon (McWilliams) replaced that first officer, and increased monitoring activities. Ultimately, Mellon seized Turco's inventory with the approval of the bankruptcy court and sold it at public and private sales. The court denied Mellon's motion for summary judgment.[86] That denial was based on the increased monitoring activities of the second Mellon officer on Turco's advisory board. The court stated that the officer's activities in monitoring cash collateral, ensuring proper application of accounts receivable and establishing a system for reporting by Turco to Mellon would not likely give rise to CERCLA liability for Mellon.[87] However, the court found a genuine issue of material fact to exist concerning the possibility of day-to-day involvement by the second advisory board member stating:

> The reed upon which the Mirabiles seek to impose liability on Mellon is slender indeed; however, bearing in mind that all doubts are to be resolved in favor of that party opposing a motion for summary judgment, I conclude that, taken as a whole, the deposition testimony outlined above presents a genuine issue of fact as to whether Mellon Bank, through its predecessor Girard Bank, engaged in the sort of participation in manage-

82. *Id.* at 20,997.
83. *Id.* at 20,996.
84. Mirabile, 15 Envtl. L. Rep. at 20,996.
85. *Id.* (emphasis added).
86. *Id.* at 20,997.
87. *Id.*

> ment which would bring a secured creditor within the scope of CERCLA liability. In particular, it would be helpful to have a clearer picture of McWilliams' participation in the manufacturing processes and of the extent to which Garfinkel acted at the direction of Girard.[88]

In denying summary judgment, the court specifically rejected the Mirabile's argument that Mellon would be liable under CERCLA for failure to perform an alleged affirmative duty to advance funds to conduct the hazardous waste cleanup.[89] Moreover, the court rejected the argument that the activities of the first Mellon representative on Turco's advisory board would give rise to CERCLA liability. The representative's activities were characterized by the court as "general financial advice" not related to hazardous waste production or disposal.[90]

Finally, the court granted the motion of the SBA for summary judgment.[91] First, the court rejected arguments by the Mirabiles that the SBA should be subject to CERCLA liability because of its knowledge of Turco's waste disposal practices when it administered its loan or because it earmarked loan proceeds in a manner that would have prevented improper hazardous substance disposal.[92] Second, the court rejected the Mirabiles' arguments that the loan agreement provisions allowing "some degree of involvement" could be characterized as participation in day-to-day management[93] and restrictions on Turco's finances exposed the SBA to CERCLA liability. The court emphasized that day-to-day involvement never took place[94] and that any participation which did take place was strictly limited to financial affairs.[95] That sort of involvement was not, in the court's opinion, sufficient to impose CERCLA liability because the statue specifically requires participation in the management of the "facility" in order to destroy the secured interest exemption.[96] Therefore, the court considered cases concerning the liability of shareholders who participate in management to be analogous, but not controlling, because CERCLA does not require that the management activities of shareholders giving rise to CERCLA liability re-

88. *Id.* (footnote omitted).
89. Mirabile, 15 Envtl. L. Rep. at 20,997.
90. *Id.*
91. *Id.*
92. *Id.*, 20,997 n.9.
93. *Id.* at 20,997.
94. Mirabile, 15 Envtl. L. Rep. at 20,997.
95. *Id.*
96. *Id.*

late specifically to the "facility."[97]

C. *Maryland Bank*[98]

By the time *Maryland Bank* was decided, two rules appeared to be emerging. First, foreclosure did not deny the lender the benefit of the Security Interest Exemption. Second, day-to-day management is the test for the "participation in management" standard.

Although the dicta in *Long* and the holding of *Mirabile* does support the conclusion that a secured lender does not lose the benefit of the Security Interest Exemption simply by foreclosing upon its security (i.e., the site of the hazardous substance spill) and purchasing the site at the foreclosure sale,[99] substantial doubt concerning that conclusion was created by the *Maryland Bank* case. Maryland Bank & Trust Company (Maryland Bank) had a long standing banking relationship with Herschel and Nellie McLeod. At some indeterminate point during that long relationship, Maryland Bank became aware that the McLeods were operating a trash and garbage business on a parcel of real property (the site). The business included allowing others to dump various hazardous wastes on the site. Later, the McLeods sold the site to their son and the purchase price was financed by Maryland Bank, secured by a mortgage on the site and guaranteed by the FHA. After the son's default on the loan, Maryland Bank foreclosed and purchased the site at the foreclosure sale.

While Maryland Bank still held title to the site, the Environmental Protection Agency spent over $550,000 cleaning up the site (after Maryland Bank declined to do so). The EPA then commenced this civil action against Maryland Bank under CERCLA. In reaching its decision to deny the motion of Maryland Bank for summary judgment,[100] the only issue for the court to decide was whether Maryland Bank was liable under CERCLA as a Current Owner of the site.[101]

First, the court ruled that the Security Interest Exemption could *not* apply to Maryland Bank since it had become the holder of "full

97. *Id.*

98. United States v. Maryland Bank & Trust Co., 632 F. Supp. 573 (D. Md. 1986).

99. *See supra* notes 78 and 84.

100. Maryland Bank & Trust Co., 632 F. Supp. at 582. The court held that Maryland Bank had the burden of establishing its entitlement to the security interest exemption. *Id.* at 578.

101. *Id.* at 576.

title."[102] However, the court then obscured the scope of its decision. Initially, the court reasoned that

> [t]he exemption of subsection (20)(A) covers only those persons who, at the time of the clean-up, hold indicia of ownership to protect a then-held security interest in the land. The verb tense of the exculpatory language is critical. The security interest must be held at the time of the clean-up. The mortgage held by Maryland Bank terminated at the foreclosure sale . . . at which time the security interest ripened into full title.[103]

Following this seemingly broad pronouncement, the court then indicated that the acquisition of title via foreclosure might not void the security interest exemption in all cases. Maryland Bank had held the property for an extended period of time. Accordingly, the Court did not consider the issue of whether a secured party who purchased the property at the foreclosure sale and then promptly resold it would be precluded from asserting the section 101(20)(A) exemption.[104]

In denying Maryland Bank's summary judgment motion, the court also had the opportunity to construe the confusing and inconsistent use of the words "and" and "or" in conjunction with "owner" and "operator" in the Responsible Party provisions of CERCLA. Specifically, CERCLA includes as a responsible party a person who is a current "owner and operator."[105] In contrast, liability is imposed for interests held at the time of the disposal upon persons who "owned or operated."[106] The court ruled that liability may be imposed on a current owner, even if that person is not, in addition, an operator.[107]

D. Nicolet[108]

The next reported decision provided an opportunity for a U.S. District Court to affirm the day-to-day management test. The United States had filed an action to recover clean-up costs, future clean-up costs, interest and litigation costs in connection with a " 'mountain' of asbestos containing material"[109] located on the site

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102. *Id.* at 579.
103. *Id.* (citations omitted).
104. *Id.* at 579, n.5.
105. 42 U.S.C. § 9607(a)(1) (1988).
106. *Id.* § 9607(a)(2).
107. Maryland Bank & Trust Co., 632 F. Supp. at 577. *Accord* United States v. Fleet Factors Corp., 901 F.2d 1550, 1554 n. 3 (11th Cir. 1990).
108. United States v. Nicolet, Inc., 712 F. Supp. 1193 (E.D. Pa. 1989).
109. *Id.* at 1196.

of a manufacturing facility and adjoining waste disposal sites (the site). At the time of this decision, the Environmental Protection Agency alleged that it had already spent $2,500,000 or more in the clean-up of the site.[110]

The site had for many years been owned by a corporation (Keasby) in connection with its manufacturing business. Over a period of four years from 1934 to 1938, all of the Keasby stock was acquired by Turner and Newall (T&N). In 1951, the record owner of that stock became Turner & Newall (Overseas), Ltd. (T&N(O)). Nicolet acquired the site in 1962.

The EPA alleged that T&N was a responsible party under CERCLA under various theories. T&N was alleged to be the alter ego of Keasby, the sole shareholder of a former owner and an active participant in management, a person with the capacity to abate environmental harm who had failed to do so and the holder of a mortgage on the site who had actively participated in management.[111] In denying T&N's motion to dismiss, which the court treated as a motion for summary judgment, the court stated that, "[E]xisting case law suggests that a mortgagee can be held liable under CERCLA only if the mortgagee participated in the managerial and operational aspects of the facility in question."[112]

E. Guidice[113]

The *Guidice* decision required the court to address some of the inconsistencies in the case law at that time as illustrated most clearly by contrasting the *Maryland Bank*[114] decision (Security Interest Exemption lost by purchase of property at foreclosure sale) and *Mirabile*[115] (purchase at foreclosure sale does not cause loss of Security Interest Exemption when undertaken to protect security interest). This decision was created by a citizens suit commenced against BFG Electroplating and Manufacturing Company (BFG) and based, in part, on CERCLA. BFG then joined the current owners and prior owners of adjacent land (the site), including the National Bank of

110. *Id.*
111. *Id.* at 1196-97.
112. *Id.* at 1205. The "case law" referred to by the court was the decision in *Maryland Bank*, the decision in *Mirabile* and the decision of the U.S. District Court in *Fleet Factors*. As noted below, that decision in *Fleet Factors* was affirmed by the U.S. Court of Appeals for the 11th Circuit but on the basis of different reasoning than that used by the lower court. *See infra* notes 126-41.
113. Guidice v. BFG Electroplating & Mfg., 732 F. Supp. 556 (W.D. Pa. 1989).
114. *See supra* note 102.
115. *See supra* note 84.

the Commonwealth (National Bank), as third party defendants. National Bank's involvement with the property began when it extended a secured (accounts receivable) line of credit to a former owner of the site, Berlin Metal Polishers (Berlin). Ultimately, National Bank became the holder of a mortgage on the site when it extended additional financing to Berlin and took title to the site after a foreclosure sale.

In ruling against National Bank on its motion for summary judgment, the court reviewed its activities prior to its acquisition of title to the site as well as its post-acquisition activities. The court ruled that the pre-acquisition activities were not sufficient to void the Security Interest Exemption.[116] Specifically, the court relied on the day-to-day management test in reaching this conclusion.[117] The court ruled that pre-foreclosure activities by National Bank did not rise to the level of participation necessary to destroy the Security Interest Exemption.[118] These activities included periodic meetings with Berlin officers to discuss personnel and raw materials issues, active assistance to Berlin in negotiating for an SBA loan, assistance to Berlin in connection with government rules concerning waste water discharge, periodic visits to the site after Berlin ceased operations, referral of a potential lessee, and an agreement to provide financing to a potential purchaser of the site.[119] The court characterized these activities as "prudent measures" to protect National Bank's security interest.[120] The court said that this analysis of pre-foreclosure activity by lenders would foster the goals of CERCLA by encouraging lenders to carefully monitor the waste disposal activities of debtors.[121]

The court applied a different analysis to National Bank's post-foreclosure ownership. First, the court recognized the divergence in opinion between the *Mirabile* and *Maryland Bank* courts.[122] The court, ultimately, favored the rationale of *Maryland Bank*. First, the court concluded that allowing a lender who acquires title to a hazardous waste site an exemption would create a "special class of oth-

116. Guidice, 732 F. Supp. at 562.

117. *Id.* at 561-62. In reaching this conclusion, the court relied upon *Mirabile* and *Nicolet*. *See supra* notes 79-97 and 180-112. It also relied upon the decision of the U.S. District Court in *Fleet Factors*, which was eventually affirmed by the 11th Circuit U.S. Court of Appeals based on different reasoning than used by the lower court. *See infra* notes 126-141.

118. *Id.* at 562.

119. *Id.*

120. *Id.*

121. Guidice, 732 F. Sup. at 562.

122. *Id.*

erwise liable landowners."[123] Second, the court recognized that Congress had seen fit to create such a special class in 1986 by amending CERCLA to exclude from liability certain state and local governments acquiring property in limited cases but had declined to create such a special exclusion for private lenders.[124] Accordingly, the court concluded that the Security Interest Exemption was not available for the period during which the National Bank was a record owner.[125]

F. Fleet Factors[126]

Although lenders had been uncertain about the impact of foreclosure on their exposure to CERCLA liability, the court in *Fleet Factors*, raised the level of uncertainty to new heights through its apparent rejection of the day-to-day management standard. The United States commenced this action in order to recover the cost of cleaning up hazardous waste located on the grounds of a textile manufacturing facility (the site) in Georgia which had previously been owned by Swainsboro Print Works (Swainsboro Print). The government had spent over $400,000 in the cleanup of asbestos and drums containing hazardous substances on the site.

The defendant, Fleet Factors Corporation (Fleet), began its relationship with Swainsboro Print when it entered into a factoring agreement with Swainsboro Print and received a security assignment of Swainsboro Print's accounts receivable. Fleet also received a security interest in the textile facility, its inventory, equipment and fixtures. About three years later, Swainsboro Print filed a chapter 11 bankruptcy petition. The chapter 11 petition was converted more that two years later to a chapter 7 proceeding.

The relationship between Fleet and Swainsboro Print was divided by the Court of Appeals into three time periods for purposes of analysis: (i) the period beginning with the factoring agreement and continuing until Swainsboro Print ceased operations at the time of the conversion of the bankruptcy proceeding to a chapter 7 (Phase I) about five years later; (ii) the period of slightly more than one year beginning with cessation of the operations of Swainsboro Paint, spanning the period during which Fleet foreclosed upon its security interest in inventory and equipment (not upon the facility itself) and continuing until Fleet retained a liquidator (Baldwin) to auction

123. *Id.* at 563.
124. *Id.*
125. *Id.*
126. United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990), *cert. denied*, 111 S. Ct. 752 (1991).

some of the collateral upon which Fleet had foreclosed (Phase II); and (iii) the period following the contract between Fleet Factors and Baldwin (Phase III).

During Phase III, the EPA inspection disclosed hazardous substance problems at the site. After conducting the clean-up, a county government ultimately took title to the site at a tax foreclosure sale. Fleet Factors, although it had a security interest in the site, never foreclosed upon that security interest and never took title to the site.

The U.S. District Court[127] denied Fleet Factors' summary judgment motion on the grounds that the United States had created material issues of fact concerning the availability of the Security Interest Exemption during Phase III. The U.S. Court of Appeals for the 11th Circuit upheld the denial of the motion for summary judgment but ruled that material issues of fact concerning the availability of the Security Interest Exemption existed with respect to *both* Phase II and Phase III.

The plaintiff first asserted that Fleet was liable as a Current Owner of the site. The plaintiff's theory was based on the general rule that a state or local government acquiring title through a tax foreclosure sale is not liable under CERCLA.[128] In such a case, CERCLA imposes liability on the person who was the owner or operator "immediately beforehand."[129] The court rejected the plaintiff's argument that liability is referred back to the last person who controlled the facility.[130] In this case, the county acquired tile in 1987 and the last involvement of Fleet with the site was in 1983. The plaintiff unsuccessfully argued that the site had been abandoned during the gap from 1983 to 1987 rendering Fleet the owner in control immediately before the county's acquisition of title.

In contrast, the plaintiff successfully argued that an issue of fact existed concerning the status of Fleet as a Former Owner. The court, accepting that the burden of establishing the existence of the exemption fell on Fleet[131] and that the mortgage of Fleet constituted an "indicia of ownership" within the meaning of the security interest exemption,[132] characterized the issue of the degree of lender participation required to destroy the security interest exemption as one of

127. United States v. Fleet Factors, 724 F. Supp. 955 (S.D. Ga. 1988), *aff'd*, 901 F. 2d 1550, *cert. denied*, 111 S. Ct. 752 (1991).

128. Fleet Factors, 901 F.2d at 1555.

129. 42 U.S.C. § 9601(20)(A)(iii) (1988).

130. Fleet Factors, 901 F.2d at 1555.

131. *Id.* at 1555-56.

132. *Id.* at 1556.

"first impression for the federal appellate courts."[133]

In resolving this issue, the court rejected the government's position that any involvement by the secured lender in the management of the facility destroys the Security Interest Exemption.[134] Also, it rejected the position of Fleet that participation in day to day or operational management of the facility was required to destroy the Security Interest Exemption.[135] Instead, the court stated the rule of law as follows:

> Although similar, the phrase 'participating in management' and the term 'operator' are not congruent. Under the standard we adopt today, a secured creditor may incur section 9607(a)(2) liability, without being an operator, *by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes.* It is *not necessary for the secured creditor to actually involve itself in the day-to-day operations of the facility* in order to be liable — although such conduct will certainly lead to loss of the protection of the statutory exemption. *Nor is it necessary for the secured creditor to participate in management decisions relating to hazardous waste.* Rather, a secured creditor will be liable if its *involvement with the management* of the facility is sufficiently broad to support the *inference that it could affect hazardous waste disposal decisions if it so chose*; we therefore specifically reject the formulation of the secured creditor exemption suggested by the district court in *Mirabile.*[136]

Fleet Factors adopted a combined actual management/capacity to influence test. In other words, the test can reasonably be interpreted to require some actual "involvement in management", although that participation need not necessarily relate to the hazardous waste practices of the borrower. If the threshold level of managemement involvement by the lender exists, the lender will then lose the Security Interest Exemption because its actual involvement creates an inference that it could affect hazardous waste decisions if it chose to do so. Secured lenders were justifiably alarmed by the decision. Could a mere "capacity to influence" a borrower's affairs, standing alone, be enough to serve as the basis for CERCLA liability?

In the view of the Eleventh Circuit U.S. Court of Appeals, the

133. *Id.*
134. *Id.*
135. Fleet Factors, 901 F.2d at 1557-58.
136. *Id.* (footnotes and citations omitted and emphasis added).

actual management/capacity to influence test would promote the purposes of CERCLA by encouraging a thorough investigation by potential creditors.[137] In fact, the court stated that the test does not "preclude a secured creditor from monitoring any aspect of a debtor's business" and allows the lender to have involvement in "occasional and discrete financial decisions relating to the protection of its security interest."[138]

In applying this new test, the court agreed with Fleet that it did not have a sufficient degree of involvement during Phase I to lose the exemption.[139] Its activities during that period consisted of advancing funds against the debtor's accounts receivable, paying and arranging for payment of security deposits on state utility services to the debtor and advising the debtor that it would not advance additional funds when the unpaid advances would exceed the accounts receivable balance.

The court disagreed with the U.S. District Court concerning Phase II. The activities of Fleet during Phase II were sufficient participation to destroy the exemption.[140] During Phase II, Fleet Factors allegedly required the debtor to seek its approval before making customer shipments, set the value of excess inventory, determined the date and the destination of the shipment of finished goods, controlled major personnel decisions including layoffs and employment tax form processing, supervised the office administrator, controlled access to the site and hired Baldwin as a liquidator.

The court agreed with the U.S. District Court that the activities of Fleet during Phase III were enough to destroy the exemption. In fact, the court said Fleet Factor's level of involvement during Phase III would, if proven, rise to "operator" status.[141] This arguably renders all of the courts statements concerning management participation mere dicta.

G. *Bergsoe Metal*[142]

Shortly following the *Fleet Factors* decision, secured creditors received conflicting signals from the U.S. Court of Appeals for the Ninth Circuit. The Ninth Circuit, in delivering these signals, was apparently not impressed by the drafting efforts of the legislators in

137. *Id.* at 1558.
138. *Id.*
139. *Id.* at 1559.
140. Fleet Factors, 901 F.2d at 1559.
141. *Id.* at 1559-60.
142. Bergsoe Metal v. East Asiatic Co., 910 F.2d 668 (9th Cir. 1990).

the enactment of CERCLA. As stated by the court, CERCLA "provides that the 'owner' of a contaminated facility is liable for the costs of cleanup. It is left for the courts, however, to clean up the mess left behind by complicated financial transactions. We search for the CERCLA owner."[143] After concluding its search, the court determined that the "owner" in this particular case was not the lender.

A municipal corporation (the Port) in Oregon sold land (the site) to a corporation (Bergsoe) to operate a lead recycling facility. Subsequently, Bergsoe conveyed the site to the Port and leased the site back from the Port with an option to purchase the site. The Port then issued revenue bonds and mortgaged the site and assigned the lease to United States National Bank of Oregon (U.S. Bank), as trustee for the bondholders, in order to secure payment of the bonds.

Bergsoe experienced financial difficulties and, after declaration of a default by U.S. Bank on the leases, entered into a workout agreement providing for operation of the site by another corporation (Front Street). U.S. Bank and the Port agreed, as part of this workout, not to foreclose. Unfortunately, Front Street was unable to run the operation successfully, Bergsoe was involuntarily placed into bankruptcy by U.S. Bank, and the state of Oregon identified the presence of hazardous substances on the site. U.S. Bank ultimately commenced a proceeding to collect Bergsoe's obligation to the bondholders. That proceeding included a request for an order declaring Bergsoe's shareholders liable for the cleanup costs. In turn, the defendants in that proceeding asked for an order declaring U.S. Bank and the Port liable for those costs.

The Port relied on the Security Interest Exemption in support of its motion for summary judgment. First, the court reasoned that the deed to the site was held by the Port for the purpose of ensuring that Bergsoe would meet its financial obligations and, therefore, was a security interest for purposes of CERCLA.[144] Despite this conclusion, the court recognized that the Port could be liable under CERCLA if it participated in management.[145] In determining whether the Port had participated, the court recognized *Fleet Factors* as the sole appellate decision to have addressed this specific issue.[146] However, the court specifically declined the opportunity to formulate a Ninth Circuit test for participation. The court reasoned that some

143. *Id.* at 669.
144. *Id.* at 671.
145. *Id.* at 672.
146. *Id.*

level of actual participation by the lender is necessary and that, since there was no participation at all by the Port, it was not necessary to determine where to draw the line.[147]

The court rejected the Port's assertion that its encouragement of the building of the lead recycling facility and its negotiation with Bergsoe concerning its decision to build the facility constituted participation in management. The court stated that these activities did not fall in the class of activities properly labeled as management.[148]

Most importantly, the court rejected Bergsoe's assertion that rights reserved to the Port in the leases, but not actually exercised, destroyed the exemption. The court did not consider this decision to be in conflict with the *Fleet Factors* decision. In fact, the court stated:

> EAC generally *errs in equating the power to manage with actual management. As did the Eleventh Circuit in Fleet Factors, we hold that a creditor must, as a threshold matter, exercise actual management authority* before it can be held liable for action or inaction which results in the discharge of hazardous wastes. *Merely having the power to get involved in management, but failing to exercise it, is not enough.*[149]

Finally, the court rejected Bergsoe's assertion that the Port's involvement in the decision to hire Front Street constituted participation by the Port. The court found no evidence of the Port's participation in the decision to hire. The court concluded that the Port was not in a principal-agent relationship with U.S. Bank which would make it responsible for the Bank's decisions.[150]

At this point in time lenders faced two critical questions. Would foreclosure, or its equivalent, void the Security Interest Exemption? Would normal lender activities be enough participation in management to void the Security Interest Exemption?

V. EPA Rule — Proposed (1991) and Final (1992)

Largely in response to the confusion and furor created by the *Fleet Factors* decision,[151] the EPA began work in 1990 on an admin-

147. Bergsoe Metal, 910 F.2d at 672.
148. *Id.*
149. *Id.* at 673 n.3 (emphasis added).
150. *Id.* at 673.
151. *See* the statement of the EPA concerning the background for the Final EPA Rule. 57 Fed. Reg. 18,344, 18,345 (1992); and Howard and Gerard, *supra* note 2, at 1188 (discussing the "mixed signals" sent to lenders by Congress, the EPA and the courts, the authors state that *Fleet Factors* "has triggered a flurry of negative reactions and has led to efforts by Con-

istrative rule to clarify the scope of the Security Interest Exemption. A draft of that rule was sent by the EPA to the Office of Management and Budget (OMB) in September of 1990. Subsequently, OMB returned the draft rule to the EPA for revision.[152] A draft of a revised rule was then published by private sources in February 1991.[153] The proposed rule (the Proposed EPA Rule) was officially Published in June 1991,[154] and the Final EPA Rule was published in April 1992.[155]

The Final EPA Rule is structured as a revision of the National Oil and Hazardous Substances Contingency Plan.[156] The apparent intent of the EPA in adopting this approach was to create a legal argument that the Final EPA Rule is binding, not only in actions commenced by the federal government, but in actions commenced by

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gress and, to and extent, the EPA to limit or reverse the decision").

152. *EPA's Draft Says Creditors Using Standard Practices Exempt From Liability*, BNA's Banking Rept., Feb. 25, 1991, at 334.

153. *Draft EPA Proposal on Lender Liability Under CERCLA Obtained by BNA on Feb. 14, 1991*, BNA's BANKING REP., Feb. 25, 1991, at 370 (containing the text of the draft as it then existed).

154. 56 Fed. Reg. 28,798 (1991) (proposed June 24, 1991) [hereinafter the Proposed EPA Rule]. The text of the proposed rule was published in BNA's Banking Report. *EPA Proposal to Limit Liability of Financial Institutions Under CERCLA*, BNA's BANKING REPT., June 10, 1991, at 1104. *See generally* Sitomer, *Fleet Factors Decision Haunts Banks No More*, BANKERS MAG., Jan./Feb. 1992, at 63; Sellinger and Chapman, *EPA's Proposed Rule on Lender Liability Under CERCLA: No Panacea for the Financial Services Industry*, 21 E.L.R. 10618 (1991); Scranton, *Issues in Lending. . .How the Proposed EPA Rule Affects Lender Liability*, J. OF COM. BANK LENDING, Oct. 1991, at 18; O'Brien and Nooney, *supra* note 7; Cope, *EPA Proposal Would Protect Banks From Cleanup Liability*, AM. BANKER, June 6, 1991, at 2; Wolf, *EPA's Lender Liability Rule: No Surprises But More Work Needed*, 21 E.L.R. 1006 (1991); and Miano, *Part 1: Providing Lenders With Superfund Relief*, Mergers and Acquisitions, July/Aug. 1991, at 28. In addition to addressing the scope of the security interest exemption, the Proposed EPA Rule addressed the liability under CERCLA of governmental entities that involuntarily acquire property contaminated by hazardous substances. That issue is beyond the scope of this article.

155. 57 Fed. Reg. 18,344 (1992) (to be codified at 40 C.F.R. 300, Subpart L) (published Apr. 29, 1992) *See generally* Copple and Stern, *Lender Liability Rule Leaves Questions*, AM. BANKER, July 7, 1992, at 4; Nielsen, *"Traditional" Banking Will Not Lead to Superfund Liability, Says EPA*, MAG. OF BANK MGMT., June 1992, at 20; Robb and Sotto, *EPA's Rule Provides Map to a Minefield*, AM. BANKER, June 30, 1992, at 4 (in which the title is, perhaps, the slip of a pen properly referring to a map through a minefield);O'Brien and Gibson, *Final EPA Rule Allows Traditional Lender Activities Without Superfund Liabilities*, BNA ENV'T REP., May 15, 1992, at 326; and Hathaway, *EPA Final Rule on Lender Liability Under CERCLA*, TOXICS L. REP., Apr. 29, 1992, at 1466; *EPA Sets Two Pronged Test for Lenders to Determine Participation in Management*, THE MORTGAGE MARKETPLACE, May 11, 1992, at 4; and Margaret V. Hathaway, *EPA Rule on Lender Liability Under Federal Superfund Law*, BNA BANKING DAILY, May 6, 1992. The Final EPA Rule has already been challenged in federal court. *See EPA Lender Liability Rule Challenged in D.C. Circuit, ABA Plans to Intervene*, 59 BNA's BANKING REP. 218 (Aug. 10, 1992) (Michigan's attorney general claims that "the EPA went beyond a mere interpretation of the statute by creating exemptions for secured creditors, and also charged the rule will encourage banks to begin operating contaminated facilities).

156. 57 Fed. Reg. 18,344, 18,382 (1992).

private parties as well.[157] Despite this approach, it remains unclear whether, and to what extent, courts will consider the Final EPA Rule to be binding in actions commenced by private parties.[158] Even in an action by the federal government, it is not certain that courts will find the administrative interpretation of the Security Interest Exemption embodied in the Final EPA Rule to be persuasive.[159]

In addition to the uncertainties surrounding the application of the Final EPA Rule to private party plaintiffs and its binding power, the rule leaves a number of significant gaps in coverage.[160] For example, many financial institutions acquire interests in property in a fiduciary capacity. The Final EPA Rule does not apply to the potential liability of financial institutions in that arena.[161] Nor does the Final EPA Rule apply to unsecured creditors.[162] Also, lenders have potential environmental liability exposure under many laws other

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157. *Id.* at 18,368.

158. *EPA Official Says Secured Lenders Should Look Ahead to Third Party Actions*, BNA'S BANKING REP., Aug. 19, 1991, at 309. *See* the commentary of the EPA on the Final EPA Rule in which the EPA makes reference to the numerous comments received on the Proposed EPA Rule questioning whether that rule would apply to private party litigation. 57 Fed. Reg. 18,344, 18,368 (1992).

159. It is the position of the EPA that the Final EPA rule is a "legislative" or "substantive" rule as opposed to an "interpretive" rule. In addition, the EPA argues that, even were the Final EPA rule deemed to be interpretive, it would be entitled to substantial deference in the process of judicial review. However, the EPA pointed out in its commentary to the Final EPA rule that commenters had taken the position that the rule would not be binding on the courts. 57 Fed. Reg. 18,344, 18,368 (1992). *See* Hathaway, *EPA Rule on Lender Liability Under the Federal Superfund Law*, *supra* note 155 (pointing out that the Final EPA Rule will likely be challenged in court in the near future).

160. *See generally Banks, Bankers Still Need Protection From Environmental Risk, Expert Says*, BNA BANKING DAILY, Oct. 26, 1992; Robb and Sotto, *supra* note 155 (laws other than CERCLA still a risk); *Legislative Protection for Lenders Still Needed After EPA CERCLA Rule*, BNA'S BANKING REP., May 18, 1992, at 872 (liability under RCRA and fiduciary liability still risks); O'Brien and Gibson, *supra* note 155 (third parties may not be bound, RCRA and state statutes not covered, unsecured creditors and fiduciaries not protected);and Hathaway, *EPA Rule on Lender Liability Under the Federal Superfund Law*, *supra* note 155 (proceedings in progress may not be covered, liability under other federal laws not addressed and fiduciaries and unsecured creditors not protected).

161. 57 Fed. Reg. 18344, 18,349 (1992). In its commentary to the Final EPA Rule, the EPA takes the position that there is no statutory basis for treating fiduciary liability as part of the rule. However, the EPA states in that commentary that innocent fiduciaries are not generally liable under CERCLA. *Id.* at 18,349. *See generally New EPA Proposal Won't Shelve Lender Liability Legislation*, BANKING POL'Y REP., July 1, 1991, at 4 (commenting on this gap in coverage in the Proposed EPA Rule); Adams, *Environmental Hazards for Fiduciaries: An Acid Test*, TRUSTS AND ESTATES, Jan. 1992, at 24; Ries and Christel, *Fiduciary Liability on the Rise: Bankers Can Prevent Liability in the Face of Increasing Litigation*, MAG. OF BANK MGMT., June 1991, at 25; and Colleen Johnson, *Bankers Beware of Pollution Liability: Expert*, BUS. INS., Feb. 11, 1991, at 15. *But see Fiduciary Not Liable As Owner Under CERCLA*, Federal Judge Holds, 59 BNA'S BANKING REG., 544 (Oct. 12, 1992) (federal district court judge rules that bank trustee of contaminated realty, without other incidents of ownership, is not liable as owner under CERCLA).

162. 57 Fed. Reg. 18,344 (1992).

than CERCLA.[163] The Final EPA Rule does not apply to Resource Conservation and Recovery Act (RCRA) liability or to any other source of liability other than CERCLA.[164] Furthermore, the Final EPA Rule does not spell out in detail what affirmative duties, if any, the law places upon a lender to assure that cleanup of a hazardous substance spill takes place. Although the commentary to the Final EPA Rule does state that a lender is "not expected to be an insurer or guarantor of environmental safety or quality,"[165] it does not specify what affirmative duties, if any, the law places upon the secured lender at the various stages of the lending process.[166] As a result, federal legislation is needed to plug these significant gaps despite the finalization of the EPA rule.[167]

Although these gaps are significant, the Final EPA Rule does provide substantial guidance for lenders and, in most respects, is a significant improvement over the Proposed EPA Rule.[168] The Final EPA Rule's coverage is extremely broad. Although the courts and commentators have discussed the different applications of the Security Interest Exemption in "lien theory" and "title theory" jurisdictions,[169] the commentary to the Final EPA Rule expressly recognizes that the rule will be applied in the same manner in both "lien theory" and "title theory" jurisdictions.[170] Similarly, the Final EPA Rule covers virtually all methods used by lenders to secure loans. The Final EPA Rule focuses on the lender's motivation in determining whether the particular method chosen by the lender falls within the scope of the Security Interest Exemption. The lender's primary motivation must be to protect its security interest in order to be within the scope of the Security Interest Exemption.[171] This "functional transactional" approach includes lenders nominally holding a

163. *See supra* note 42.

164. 57 Fed. Reg. 18,344, 18,349-351 (1992). *E.g.*, *Bank Witnesses Endorse Legislation Over EPA Rule to Address Lender CERCLA Liability*, BNA's BANKING REP., June 17, 1991, at 1132.

165. 57 Fed. Reg. 18,344, 18,377 (1992).

166. *E.g.*, James Dabney Miller and Kerrie S. Covell, *EPA's Lender Liability Rule Needs Polishing*, AM. BANKER, Apr. 12, 1991, at 4.

167. *Legislative Protection For Lenders Still Needed After EPA CERCLA Rule*, *supra* note 160; Sellinger and Chapman, *supra* note 154.

168. *Banks Should Be Encouraged to Lend on Contaminated Property, Expert Says*, 59 BNA's BANKING REP. 608 (Oct. 26, 1992); Nielsen, *supra* note 155 (banker concerns should "ease significantly"); O'Brien and Gibson, *supra* note 155 ("significant step for the lending community").

169. *E.g.*, Note, *Clean Up the Debris After Fleet Factors: Lender Liability and CERCLA'a Security Interest Exemption*, *supra* note 25 at 1258.

170. 57 Fed. Reg. 18,344, 18,352 (1992).

171. *Id.* at 18,344-345.

lessee's interest, guarantors and subsequent holders.[172]

The fact that the Final EPA Rule makes a significant improvement in the law does not end the matter, however. Lenders are risk averse and any significant uncertainties in the law will act as a deterrent to normal lending activities. It is, therefore, necessary to review the application of the Final EPA Rule at the various stages of the normal lending process to determine at which stage the rule is likely to create legal uncertainties. That analysis is presented below.

A. Lender Activities Before the Loan

Activities of the lender before it acquires an indicia of ownership in the property are, according to the EPA explanation of its Final EPA Rule, "irrelevant"[173] for purposes of the Security Interest Exemption.[174] The "irrelevant" language used by the EPA in its explanation of the Final EPA Rule is even stronger than that used in the Proposed EPA Rule.[175]

An example of a common pre-loan practice is the use of environmental audits. In the last several years, many lenders have adopted the advice of numerous commentators and now require environmental audits before making environmentally sensitive loans as a means of managing the potential for CERCLA liability.[176] The Final EPA Rule recognizes that, since these audits pre-date the prospective lender's acquisition of an indicia of ownership in the facility, they simply have no bearing on the availability of the Security Interest Exemption.[177] Specifically, neither the failure to obtain an audit nor the act of obtaining or requiring an audit may be used against a lender asserting the availability of the Security Interest Exemption.[178] Similarly, requiring the prospective borrower to clean up the property based on information revealed by the audit is not evidence of participation in management by the lender.[179] In this respect, the Final EPA Rule language is, again, broader than the language in the

172. *Id.* at 18,375.
173. 57 Fed. Reg. at 18,376.
174. *Id.* at 18,383 (to be codified at 40 C.F.R. sec. 300.1100(c)(2)(i)).
175. *Compare* the explanation of the Proposed EPA Rule concerning lenders activities in connection with the loan application. 56 Fed. Reg. 28,798, 28,803 (1992) (in which the EPA stated that these activities were not evidence of participation in management).
176. *E.g., Lenders Get Advice on CRA Compliance, Environmental Liability Avoidance*, BNA'S BANKING REPT., July 1, 1991, at 7; Johnson, *supra* note 161; Schnapf, *supra* note 11; Beutelschies, *supra* note 23; and Rowley and Witmer, *supra* note 23.
177. 57 Fed. Reg. 18,344, 18,353, 18,376-377, 18,383 (to be codified at 40 C.F.R. sec. 300.1100(c)(2)(i) (1992).
178. *Id.*
179. *Id.*

Proposed EPA Rule in that it specifically permits the lender to remain within the scope of the Security Interest Exemption whether this activity is required "prior to or subsequent to the time that indicia of ownership are held."[180]

Despite the EPA's clarification that pre-loan activities are irrelevant for purposes of the Security Interest Exemption, the EPA commentary on the Final EPA Rule does recognize the advisability of these environmental audits for other reasons. Specifically, it recognizes that availability of the Innocent Landowner Defense may depend, in part, on whether the lender acquired an appropriate environmental audit.[181]

There are significant differences in this respect between the Final EPA Rule and the draft which circulated in early 1991. The earlier draft attempted to meld the Innocent Purchaser Defense and the Security Interest Exemption in connection with the use of environmental audits. The earlier draft recognized the need to inquire into previous ownerships and uses of the site in order to qualify for the Innocent Landowner Defense. It provided that a lender requiring an audit would create evidence of a "highly probative" nature in determining the availability of the Security Interest Exemption.[182] The Final EPA Rule, in contrast, recognizes that CERCLA itself draws no such direct connection between the Innocent Landowner Defense and the Security Interest Exemption.[183] This appears to be a valid legal conclusion by the EPA. However, the practice of requiring environmental audits in appropriate cases is sound from a policy standpoint and should be encouraged. Therefore corrective federal legislation should require the agencies supervising lenders to adopt standards to define the circumstances under which these audits are required. Lenders meeting those standards should then be placed within a safe harbor for purposes of the Innocent Landowner defense.

B. General Participation in Management Test

The most significant change from the Proposed EPA Rule to the

180. *Compare* the provisions of the Proposed EPA Rule. 56 Fed. Reg. 28, 798, 28,809 (1991). In both the Proposed EPA Rule and the Final EPA Rule, this provision is contained in the section of the rule dealing with actions of the lender at the inception of the loan. However, the provisions in the Final EPA Rule parenthetically refer to such actions subsequent to that time although such parenthetical reference would logically fit in a later portion of the rule.

181. 57 Fed. Reg. 18,344, 18,353 (1992).

182. *Draft EPA Proposal on Lender Liability Under CERCLA Obtained by BNA Feb. 14, 1991*, *supra* note 153.

183. 57 Fed. Reg. 18,344, 18,353 (1992).

Final EPA Rule is the articulation by the EPA of the test (the General Test) for determining whether a lender has participated in management.[184] Both the Proposed EPA Rule version and the Final EPA Rule version are two-pronged tests which expressly reject the *Fleet Factors* "capacity to influence" standard.[185] The significant differences are:

1. The first prongs of both tests address the lender's decision making control over the borrower's environmental law compliance activities. The Final EPA Rule rejects its predecessor's approach which would have required that the lender's control have actually resulted in a release or threatened release of a hazardous substance in order to constitute participation in management by the lender;[186]

2. The second prong of the Final EPA Rule is broken down into two subparts to close a perceived loophole in the Proposed EPA Rule. Specifically, a lender under the General Test in the Proposed EPA Rule could "carve-out" in its loan documentation any power to control it's borrower's environmental compliance and, by so doing, avoid the application of the General Test.[187] The Final EPA Rule avoids this problem by applying the second prong of the General Test. The second prong focuses on whether the lender (i) takes day-to-day control of environmental compliance of the borrow *or* (ii) takes day-to-day control of the operational aspects of the borrower's business.[188] For this purpose, operational aspects of the borrower's business specifically exclude financial and administrative aspects.[189]

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184. *Compare* the test as articulated in the Proposed EPA Rule at 56 Fed. Reg. 28,798, 28,809 (1991) with the test under the Final EPA Rule at 57 Fed. Reg. 18,344, 18,383 (1992) (to be codified at 40 C.F.R. sec. 300.1100(c)(1)).

185. *Compare* the EPA explanations of the provisions of the Proposed EPA Rule at 56 Fed. Reg. 28,798, 28,803 (1991) with those of the Final EPA Rule at 57 Fed. Reg. 18,344, 18,379-380 (1992).

186. *Compare* the provisions of the Proposed EPA Rule at 56 Fed. Reg. 28,798, 28,809 (1991) with the provisions of the Final EPA Rule at 57 Fed. Reg. 18,344, 18,383 (1992) (to be codified at 40 C.F.R. sec 300.1100(c)(1)(i)). *See* the EPA's explanation of this change at 57 Fed. Reg. 18,344, 18,359 (1992).

187. 56 Fed. Reg. 28,798, 28,809 (1991). *See* the EPA explanation of the elimination of this "carve out" potential at 57 Fed. Reg. 18,344, 18,360 (1992).

188. *Id.* at 18,383 (1992) (to be codified at 40 C.F.R. sec. 300.1100(1)(ii)(A)and(B)).

189. 57 Fed. Reg. 18,344, 18,383 (1992) (to be codified at 40 C.F.R. sec. 300.1100(c)(1)(ii)(B). The operational aspects of the borrower's business include functions commonly handled by a plant manager, an operations manager, a chief operating officer or a chief executive officer. The financial or administrative aspects of the borrower's business (in which the lender may participate without abandoning the benefits of the Security Interest Exemption) include, in contrast, functions commonly handled by a credit manager, an accounts payable/receivables manager, a personnel manager, a controller or a chief financial officer. *Id.*

C. *Loan Documentation*

In addition to environmental audits, many commentators have suggested that lenders include various restrictive covenants in their loan documents in order to reduce potential CERCLA liability.[190] The Final EPA Rule provides that the inclusion of provisions are of this type are not to be considered evidence of management participation by the lender.[191] As examples of permissible provisions, the Final EPA Rule endorses the following: a contractual duty of the borrower to clean up hazardous substances on the property; an assurance of continuing compliance by the borrower with environmental laws; permission for periodic monitoring and inspection by the lender of the borrower's property; and permission to monitor and inspect the debtor's business and financial condition.[192]

These contractual provisions, now specifically permitted by the Final EPA Rule, are the type of provisions which many commentators had correctly identified as potentially running afoul of the *Fleet Factors* "capacity to influence" test.[193] However, the EPA commentary states that the position taken by the Final EPA Rule is consistent with *Fleet Factors*. The commentary states that ". . . this final rule does not administratively overturn or overrule *Fleet Factors* . . ." because that decision did not hold that a mere capacity to influence voided the Security Interest Exemption.[194] Despite this position of the EPA, lenders should remain concerned that a court will ultimately find that the EPA has misread the Security Interest Exemption and *Fleet Factors* and hold the Final EPA Rule to be an invalid interpretive administrative rule.

In addition to discussing the impact of contractual provisions upon the Security Interest Exemption, the commentary to the Final EPA Rule states the position of the EPA that the lender is not "expected to be an insurer or guarantor of environmental safety at a facility in which it has a security interest."[195] Since the EPA's position refers only to liability under CERCLA and not to liability under contractual or tort theories that may exist (such as aiding and abetting),[196] lenders will continue to be concerned about inclusion of

190. *E.g*, Davidson, *supra* note 23; Smith, *supra* note 19.
191. 57 Fed. Reg. 18,344, 18,356, 18,377, 18,383 (1992) (to be codified at 40 C.F.R. sec. 300.1100(c)(2)(ii)).
192. *Id.*
193. *See, e.g.*, Grady, *supra* note 23.
194. 57 Fed. Reg. 18,344, 18,369 (1992).
195. *See supra* note 165.
196. *See supra* note 24.

such provisions in their loan documents because those provisions may appear to place otherwise nonexistent affirmative duties on the lender.

D. Policing and Workout

The Final EPA Rule broadly endorses many policing and workout activities commonly undertaken by lenders in connection with the administration of a loan prior to default as well as in connection with the borrower's default or anticipated default.[197]

1. Policing.—A significant change from the approach taken by the Proposed EPA Rule is found in the provisions of the Final EPA Rule's provisions concerning policing of the loan. The section of the Proposed EPA Rule entitled "Policing the Security Interest or Loan" stated, "Actions that are consistent with protecting a security interest do not constitute participation in management for purposes of section 101(20)(a) of CERCLA."[198] The Proposed EPA Rule then provided a list of lending activities which were *specifically included* on that list.[199] Lending activities specifically described on that list appeared to fall within a safe harbor.

In contrast, the section of the Final EPA Rule entitled "Policing the Security Interest or Loan" states, "A holder who engages in policing activities prior to foreclosure will remain within the exemption provided that the holder does not by such actions participate in management of the vessel or facility as provided in 40 C.F.R. 300.1100(c)(1)."[200] The Final EPA Rule then provides a list of activities which *may be included* on that list (i.e., as long as the General Test is satisfied).[201] This language difference is critical. This section is not structured as a safe harbor for lenders engaging in one of the specifically listed activities as appeared to be the case under the Proposed EPA Rule. Even if an activity is specifically listed, it must still satisfy the General Test in order for the Security Interest Exemption to be available.

2. Workout.—Another significant change from the Proposed EPA Rule is contained in the workout provisions of the Final EPA

197. 57 Fed. Reg. 18,344, 18,383 (1992) (to be codified at 40 C.F.R. sec. 300.1100(c)(2)(ii)).
198. 56 Fed. Reg. 28,798, 28,809 (1991).
199. *Id.*
200. 57 Fed. Reg. 18,344, 18,383 (1992) (to be codified at 40 C.F.R. sec. 300.1100(c)(2)(ii)(A)).
201. *Id.*

Rule. The Proposed EPA Rule would have required that the activities of the lender be limited to those necessary to "protect and preserve the security interest in an effort to prevent default . . . or the diminution in value of the security."[202] The Final EPA now defines the term "workout" and the definition includes prevention, cure and mitigation of default and the protection and preservation of the value of the security.[203] The Final Rule specifically sanctions these activities "at any time prior to foreclosure."[204] Furthermore, the Final EPA Rule expands the non-exclusive list of examples of permissible workout activities beyond the list contained in the Proposed EPA Rule.[205] As an example of the increased coverage of the Final EPA Rule, the Proposed EPA Rule referred only to "financial advice"[206] whereas the Final EPA Rule refers to "financial or other advice."[207]

E. Good Samaritan Provisions

The Proposed EPA Rule did not specifically refer to the so-called Good Samaritan Provisions of CERCLA.[208] The Final EPA Rule specifically permits these actions.[209] In fact, it carves those activities out of the General Test.[210] In other words, a lender who takes appropriate response action under 107(d)(1) of CERCLA is not deemed to participate in management even though that action would otherwise run afoul of the General Test.

F. Foreclosure

The Final EPA Rule takes the position that the acquisition of title to the contaminated property by the lender in connection with foreclosure (or an equivalent of foreclosure) does not automatically void the Security Interest Exemption.[211] For example, a lender who

202. 56 Fed. Reg. 28,798, 28,809 (1991).

203. 57 Fed. Reg. 18,344, 18,383 (1992) (to be codified at 40 C.F.R. sec. 300.1100(c)(2)(ii)(B)).

204. *Id.*

205. *Compare* the list of permissible activities in the Proposed EPA Rule at 56 Fed. Reg. 28,798, 28,809 (1991) with the list of permissible activities in the Final EPA Rule at 56 Fed. Reg. 18,344, 18383 (1992).

206. 56 Fed. Reg. 28,798, 28,809 (1991).

207. 57 Fed. Reg. 18,344, 18,383 (1992).

208. 42 U.S.C. § 9607(d)(1) (1988).

209. 57 Fed. Reg. 18,344, 18,383 (1992) (to be codified at 40 C.F.R. sec. 300.1100(c)(2)(iii)).

210. *Id.*

211. 57 Fed. Reg. 18,344, 18,360-362, 18,377-379, 18,383 (1992) (to be codified at 40 C.F.R. sec. 300.1100(d)(1)). The Final EPA Rule also contemplates the possibility that the lender could reap a windfall if the EPA conducted a response action while the lender held an interest in the property. Therefore, the EPA commentary on the Final EPA Rule indicates

purchases the property at the foreclosure sale or who accepts a deed in lieu of foreclosure may still retain the benefit of the Security Interest Exemption.[212] This pronouncement by the EPA is another reason why lenders remain concerned about the validity of the Final EPA Rule. A court may find this provision to be an invalid administrative interpretation of CERCLA.[213]

Although title acquisition does not automatically void the Security Interest Exemption, the Final EPA Rule does require that the lender's post-foreclosure activities demonstrate that the lender is holding the property primarily to protect its security interest as opposed to acting as an investor.[214] Therefore, the "General Post-Foreclosure Test" in the Final EPA Rule requires that the lender attempt to divest itself of the property in a "reasonably expeditious manner" using "whatever commercially reasonable means are relevant or appropriate" after all facts and circumstances of the particular transaction are taken into account.[215] This General Post-Foreclosure Test does not, however, permit a lender who participated in the management of its debtor prior to acquisition of title to bootstrap itself into the Security Interest Exemption through foreclosure.[216]

The adoption of this General Post-Foreclosure Test in the Final EPA Rule adds significant protection for lenders beyond the protection provided by the Proposed EPA Rule. Specifically:

> 1. Under the proposed EPA Rule the lender was required to list the property with a broker, dealer or agent dealing in property of that type and to begin advertising the property in a specific manner (as set out in the Proposed EPA Rule) within twelve months following foreclosure.[217] However, failure to comply with that specific process as outlined by the Proposed EPA Rule would have resulted in a loss of the Security Interest Exemption even if another process made better business sense for

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that the EPA will assert a lien upon the property in that instance and seek equitable reimbursement from the lender. However, the EPA specifically answered concerns of commentators on the Proposed EPA Rule by stating this lien will not be treated as a "superlien." 57 Fed. Reg. 18,344, 18,368 (1992).

212. *Id.*

213. The EPA commentary on the Final EPA Rule noted that a significant number of commentators on the rule had disagreed with the EPA's position that acquisition of ownership by the lender does not necessarily cause loss of the benefits of the Security Interest Exemption. The EPA responded by saying that "[t]he holding of *Maryland Bank & Trust*, is therefore, consistent with allowing foreclosure under certain circumstances without voiding the exemption." 57 Fed. Reg. 18,344, 18,361 (1992).

214. 57 Fed. Reg. 18,344, 18,384 (1992) (to be codified at 40 C.F.R. 300.1100(d)(1)).

215. *Id.*

216. *Id.*

217. 56 Fed. Reg. 28,798, 28,809 (1991).

that particular property.[218] In contrast, the Final EPA Rule sets up that twelve month period as a bright line through the Bright Line Post Foreclosure Test. If the lender fails to fall within that bright line, it may still satisfy the General Post-Foreclosure Test;[219]

2. The method of computing the twelve month period under the Bright Line Post-Foreclosure Test is improved. The period does not, as under the Proposed EPA Rule, commence upon the date of foreclosure.[220] That period commences, instead, upon the date on which the lender acquires marketable title.[221]

3. Whether the lender relies upon General Post-Foreclosure Test or the Bright Line Post-Foreclosure Test, the Final EPA Rule requires that the lender act promptly upon certain offers to purchase the property. Beginning six months after the lender's acquisition of marketable title, the lender may not fail to act upon (within ninety days of receipt), outbid or reject a written, bona fide, firm offer of full consideration for the property.[222] However, the Final EPA Rule is far more specific than the Proposed EPA Rule concerning the types of offers triggering this ninety day rule.[223] The Final EPA Rule, in its definition of "written, bona fide, firm offer" retained the requirements of the Proposed EPA Rule that the offer be legally enforceable, contain all material terms and be made by a ready and willing purchaser demonstrating to the lender's satisfaction its ability to perform. However, the Final EPA Rule added requirements that the offer be for cash and solely for the property in question.[224]

4. Fair consideration is, additionally, defined by the Final EPA Rule in a manner far more favorable to lenders than the definition found in the Proposed EPA Rule. As in the Proposed EPA Rule, the definition is based on the debt owing rather than

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218. *Id.*

219. 57 Fed. Reg. 18,344, 18,384 (1992). *See* the provision of the Final EPA Rule to be codified at 40 C.F.R. sec. 300.1100(d)(1) containing the General Post-Foreclosure Test and the provisions of the Final EPA Rule to be codified at 40 C.F.R. sec. 300.1100(d)(2)(i) containing the Bright Line Post-Foreclosure Test.

220. 56 Fed. Reg. 28,798, 28,809 (1991).

221. 57 Fed. Reg. 18,344, 18,384 (1992) (to be codified at 40 C.F.R. sec. 300.1100(d)(2)(i)). Note that the Proposed EPA Rule would have required the advertising to begin within the twelve month period. 56 Fed. Reg. 28,798, 28,809 (1991). In contrast, the Final EPA Rule's Bright Line Post-Foreclosure Test apparently requires the advertising to be undertaken continuously throughout that period. 57 Fed. Reg. 18,344, 18,384 (1992).

222. 57 Fed. Reg. 18,344, 18,384 (1992) (to be codified at 40 C.F.R. sec. 300.1100(d)(1) and (2)(ii)).

223. *Compare* the provisions of the Proposed EPA Rule at 56 Fed. Reg. 28,798, 28,809 (1991) with those of the Final EPA Rule at 57 Fed. Reg. 18,344, 18,384 (1992).

224. 57 Fed. Reg. 18,344, 18,384 (1992) (to be codified at 40 C.F.R. sec. 300.1100(d)(2)(ii)(B)).

upon fair market value.[225] However, the Final EPA Rule recognizes that fair market value may vary based upon the lender's priority.[226] Also, the Final EPA Rule recognizes that a lender may be required by law to reject bids which would otherwise qualify as offers for fair consideration in order to avoid liability.[227]

5. The Final EPA Rule specifically authorizes the lender to maintain the business activities of the borrower after the lender acquires title.[228] However, the Final EPA Rule does emphasize that this applies only to the Security Interest Exemption. The lender could become liable as an Arranger on Transporter of hazardous substances by virtue of those same activities.[229]

G. Retroactive Application

The Final EPA Rule became effective on April 29, 1992.[230] The EPA commentary on the Final EPA Rule states that the EPA expects that its provisions will provide guidance in evaluation of actions taken prior to the effective date.[231] Once again, it is uncertain whether a court, even if accepting the validity of the Final EPA Rule, would apply it retroactively.

H. Burden of Proof

The Proposed EPA Rule appeared to require a plaintiff to bear the burden of proving that a lender was not entitled to the Security Interest Exemption.[232] The Final EPA Rule recognizes the questionable legal basis for that approach.[233] Although the Final EPA Rule retains the language from the Proposed EPA Rule with minor modifications,[234] the EPA commentary to the Final EPA Rule recognizes

225. *Compare* the definition found in the Proposed EPA Rule at 56 Fed. Reg. 28,798, 28,809 (1991) with the Final EPA Rule definition at 57 Fed. Reg. 18,344, 18,834 (1992) (to be codified at 40 C.F.R. sec. 300.1100(d)(2)(A)).

226. *Id.*

227. *Id.*

228. 57 Fed. Reg. 18,344, 18,384 (1992) (to be codified at 49 C.F.R. sec. 300.1100(d)(2)).

229. 57 Fed. Reg. 18,344, 18,384 (1992) (to be codified at 40 C.F.R. sec. 300.1100(d)(3)).

230. 57 Fed. Reg. 18,344, 18,374 (1992).

231. *Id.*

232. 56 Fed. Reg. 28,798, 28,808 (1991) ("If a defendant claims the exemption the plaintiff had the burden of establishing that the defendant is the owner or operator as provided in this regulation.")

233. 57 Fed. Reg. 18,344, 18,367 (1992).

234. *Id.* at 18,382 (to be codified at 40 C.F.R. sec. 300.1100) ("The plaintiff bears the burden of establishing that the defendant is liable as an owner or operator.").

that the EPA cannot shift the burdens of proof by administrative fiat.[235]

VI. Pending Federal Legislation

Four federal legislative proposals were introduced in 1991 into Congress in 1991 to deal with the above discussed uncertainty in the Security Interest Exemption.[236] Senator Jake Garn (R-UT) introduced into the Senate the Federal Deposit Insurance Improvements Act on March 13, 1991. The Act contained a proposal to amend federal laws imposing strict liability for the release or threatened release of hazardous substances (the Garn Proposal).[237] On March 14, 1992, Representative John La Falce introduced into the House of Representatives a bill to amend CERCLA and the Resource Conservation and Recovery Act of 1976 (the La Falce Proposal).[238] On March 22, 1991, Representative Wayne Owens introduced into the House of Representatives a proposal to amend CERCLA designated as the Superfund Liability Clarification Act (the Owens Proposal).[239] Finally, as part of a comprehensive banking bill, the U.S. Senate passed the Asset Conservation and Deposit Insurance Protection Act of 1991 (the 1991 Senate Proposal).[240] However, the 1991 Senate Proposal was deleted by the Conference Report[241] and did not become part of the Federal Deposit Insurance Corporation Improvement Act of 1991.[242]

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235. 57 Fed. Reg. 18,344, 18,367 (1992).

236. *See generally* Tupi and Nicholson, *Legislation to Restore CERCLA's Security Interest Exemption: Which Bill Should Lender's Support?*, TOXICS L. REP., July 3, 1991, at 161 (arguing that only the proposal of Rep. John La Face is acceptable); and Hathaway, *Federal Legislation on Lender Environmental Liability: Last Chance Before Shootout at CERCLA Corral*, TOXICS L. REP., Apr. 22, 1992, at 1434 (stating that "prospects for a 1992 enactment of the Garn or La Falce legislation, or some variation thereof, are uncertain" and that, if not enacted in 1992, are minimal until 1994 or 1995). 1991 was not the first time that such proposals were made. *See* Berz and Gillon, *supra* note 25 (summarizing the earlier legislative proposals). Note also that state legislatures have recently considered similar issues. *E.g.*, *Illinois Bill Reduces Environmental Liability for Lenders, Purchasers*, BNA BANKING DAILY, July 6, 1992; *New California Law Helps Lenders With Mortgages On Polluted Land*, BNA's BANKING REP., Nov. 18, 1991, at 802; *New Missouri Law Curtailing Lenders' Liability for Contamination Takes Effect*, BNA's BANKING REP., Sept. 9, 1991, at 364; and Andrews, *Legislators Aim to Protect Lenders From Environmental Liabilities*, INDIANAPOLIS BUS. J., Feb. 25, 1991, sec. 1, at 9A.

237. S. 651, 102nd Cong., 1st Sess., § 152 (1991). *See* the discussion of this proposal in Howard and Gerard, *supra* note 2 at 1208-13 and in Scranton, *supra* note 154 at 27.

238. H.R. 1450, 102nd Cong., 1st Sess. (1991). *See* the discussion of this proposal in Howard and Gerard, *supra* note 2 at 1213-14 and in Scranton, *supra* note 154 at 26-7.

239. H.R. 1643, 102nd Cong., 1st Sess. (1991). *See* the discussion of this proposal in Scranton *supra* note 154 at 27-28.

240. S. 543, 102nd Cong., 1 st Sess., Title X (1991).

241. H. Rep. No. 102-406, 102nd Cong., 1st Sess. (1991).

242. P.L. 102-242, 102nd Cong., 1st. Sess. (1991). *See generally Did Lender Liability*

The 1991 Senate Proposal was originally based on the Garn Proposal.[243] As it was passed by the Senate, however, the Garn Proposal was significantly changed. The 1991 Senate Proposal applied only to liability under CERCLA, not to liability under all federal environmental laws imposing strict liability.[244]

Already in 1992, another legislative proposal[245] dealing with the issue of secured lender liability under federal environmental laws has been introduced. On June 2, 1992 Senator Dole and Senator Garn introduced the Community Bank Regulatory Relief Act of 1992.[246] Title II of that legislative proposal would enact the Asset Conservation and Deposit Insurance Protection Act of 1992.[247] This proposal is substantially the same as the above-discussed 1991 Senate Proposal.[248]

The Garn Proposal would limit but not eliminate the liability of certain lenders,[249] specifically "insured depository institutions"[250] and "mortgage lenders."[251] This limitation on liability would apply, not only to CERCLA, but to "any federal law imposing strict liability for the release or threatened release of a hazardous substance."[252] In the case of an "insured depository institution," the limitation would apply to property acquired by foreclosure, to property held in a fiduciary capacity, to property held by a lessor pursuant to the

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Bill Make Some Progress This Year? BANK LETTER, Dec. 16, 1991, at 6, *Banking Bill Produces Many Winners, Losers*, BANK LETTER, Dec. 9, 1991, at 2; and *Senate-Passed Lender Liability Title Would Amend CERCLA to Protect Bankers*, BNA'S BANKING REPT., Dec. 2, 1991, at 883 (all reporting on the conference committee process which led to the exclusion of the lender liability provisions from the final 1991 banking bill).

243. *See* Title X of the version of S. 543 engrossed in the Senate on Oct. 4, 1991 (Version 2). *See generally Lender Liability Resolution May Survive Banking Bill; Protection From Cleanup Costs Sought*, THE MORTGAGE MARKETPLACE, Nov. 22, 1991, at 1 (summarizing this proposal).

244. *See* Title X of the version of S. 543 engrossed in the Senate on Nov. 24, 1991 (Version 4). *See generally Senate-Passed Lender Liability Title Would Amend CERCLA to Protect Bankers*, BNA BANKING DAILY, Nov. 26, 1991 (summarizing title X of S. 543).

245. The likelihood of legislation passing this year is far from certain. As stated in a recent article, "Although lobbyists expect Sen. Jake Garn, R-Utah, the ranking members of the Senate Banking Committee to press for lender liability legislation in the next session of Congress, a meaningful legislative change might have to wait until 1994, when the Superfund law is due for reauthorization." Kleege, *Lenders Seeking Ways to East Rain of Cleanup Liability, supra* note 23. *Congress Sidesteps Many Banking Issues, But Acts on Mainly Technical Ones*, 11 BANKING POL. REP. 2 (Oct. 19, 1992) (Although environmental liability relief for lenders and trustees "was alive until the final weeks," it was not enacted in 1992).

246. S. 2794, 102nd Cong., 2nd Sess. (1992).

247. *Id.* §§ 201-202.

248. *Compare* the proposal described *supra* note 242.

249. S. 651, 102nd Cong., 1st Sess., § 36(a)(1)-(2).

250. *Id.* § 36(h)(5).

251. *Id.* § 36(h)(2).

252. *Id.* § 36(a)(1)-(2). *See* the definition of "hazardous substance." *Id.* § 36(h)(9); and the definition of "release." *Id.* § 36(h)(8).

terms of an extension of credit and to property subject to financial control or oversight pursuant to the terms of a credit extension.[253] If the limitation in the Garn Proposal were applicable in a particular situation, the maximum liability exposure of the insured institution would be the "actual benefit conferred on such institution by a removal, remedial or other response action undertaken by another party."[254]

In addition to this general limit upon the liability of covered lenders, the Garn Proposal would effectively reverse the result of the *Fleet Factors* "capacity to influence" test. The *Fleet Factors* test provides that liability may not be based solely on the unexercised capacity to influence.[255]

The liability limitations in the Garn Proposal would not be absolute. The lender would lose the protection of these limitations in three situations: 1) if the lender caused or contributed to the release of the hazardous substance; 2) if, after acquiring the property through foreclosure or termination of the lease, the lender failed to take reasonable steps to prevent the continued release of a hazardous substance after discovering the release; or 3) if the lender actively directed or conducted operations that resulted in the hazardous substance release.[256]

The only situation in which the Garn Proposal would entirely eliminate liability which exists under current law is when that liability would otherwise be based solely on a *Fleet Factors* capacity to influence analysis. In other situations, the liability is simply limited in amount. Furthermore, that limitation of the amount of liability could be lost if any of the exceptions in the Garn Proposal applied. For example, a secured lender who has "participated in management," so as to be considered a current owner of the contaminated site, would be liable under CERCLA and would lose the liability limitation under the Garn Proposal if some of the acts which caused the lender to have "participated in management" are deemed to have "caused or contributed" to the release.

In addition to providing liability limitations, the Garn Proposal

253. S. 651, 102nd Cong., 1st Sess. § 36(a)(1)(A)-(D). *See* the definition "property acquired through foreclosure." *Id.* § 36(h)(1) (including, for example, deeds in lieu of foreclosure); the definition of "fiduciary capacity." *Id.* § 36(h)(3); and the definition of "extension of credit" (functional equivalents of loans). *Id.* § 36(h)(4).

254. *Id.* § 36(a)(1) (emphasis added). *See* the definition of "actual benefit." *Id.* at 36(b) (not to exceed "fair market value"). The lack of a clear definition of the term "actual benefit" is a major deficiency of this proposal. Howard and Gerard, *supra* note 2 at 1211.

255. S. 651, 102nd Cong., 1st Sess., § 36(a)(3).

256. *Id.* § 36(c).

addresses the issue of creating uniform standards for lender diligence at the inception of the loan. The Garn Proposal would also require the federal banking regulatory agencies and the Secretary of Housing and Urban Development, after consultation with EPA, to promulgate regulations. These regulations would require lenders to develop and implement procedures to evaluate actual and potential environmental risks.[257]

The La Falce Proposal[258] takes a different approach from the Garn Proposal in that it would amend both CERCLA and the Resource Conservation and Recovery Act of 1976. The proposed CERCLA amendments would modify the "owner or operator" definition. The result of this amendment would be to effectively reverse the result of the capacity to influence test of *Fleet Factors*.[259] Furthermore, the LaFalce Proposal would expressly provide that the lender does not lose the benefit of the Security Interest Exemption by acquisition of title through foreclosure (or deed in lieu of foreclosure) "so long as he or she diligently is proceeding to sell or convey title on commercially reasonable terms at the earliest possible time while preserving the property in the interim."[260] The protection provided to a lender by these changes in the definition of "owner or operator" would be forfeited to the extent that the lender caused or exacerbated" a release or threatened release.[261] The La Falce Proposal, also, would extend protection to fiduciaries. However, this protection would be forfeited to the extent the fiduciary caused or exacerbated a release or a threatened release.[262]

The LaFalce Proposal attempts to encourage the use of environmental audits by lenders by providing that completion of an "environmental inspection or evaluation consistent with good commercial or customary practice"[263] is to be treated as "probative evidence" of an attempt by the lender to "preserve and protect" its security.[264]

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257. *Id.* § 36(g).

258. H.R. 1450, 102nd Cong., 1st Sess. (1991).

259. *Id.* § 1(a) First, proposed paragraph 101(20)(E)(iii) would define "participating in the management of a vessel or facility" to mean "actual, direct, and continual or recurrent exercise of managerial control . . . which . . . materially divests the borrower . . . of such control. Second, proposed paragraph 101(20)(E)(iv) provides that actions to "preserve and protect the value" of the lender's security or to "assist the borrower . . . in winding down its operations" are not participation in management.

260. *Id.* § 1(a) (new paragraph 101(20)(F)(iv)). *See also*, proposed paragraph 101(20)(F)(v) expressly providing that the exercise of the right to foreclose is not participation in management. *Id.*

261. *Id.* § 1(a) (new paragraph 101(20)(F)(vi)).

262. *Id.* § 1(a) (new paragraph 101(20)(F)).

263. The required time of completion is not specified.

264. H.R. 1450, 102nd Cong., 1st Sess., § 1(a) (proposed new paragraph

The Owens Proposal[265] would amend CERCLA only. The proposal would amend both the definition of "owner or operator"[266] and the Innocent Landowner Defense.[267] The amendment of the "owner or operator" definition would effectively overrule the result of *Fleet Factors* capacity to influence test.[268] Additionally, the amendment would allow a lender to remain within the scope of the Security Interest Exemption after foreclosure and purchase at the foreclosure sale.[269] Furthermore, the definition changes would specify a number of specific lender activities which would not constitute participation in management of the borrower. The permissible activities would include conducting a Phase I environmental audit[270] and specified "workout" activities.[271] If a lender "causes or contributes to a release or threatened release", then these amendments are not to be construed to affect that lender's liability.[272]

The Owens Proposal's amendment to the Innocent Landowner Defense would create a rebuttable presumption of appropriate inquiry by the lender if a Phase I environmental audit were obtained by the lender. The Owens Proposal describes an appropriate audit with great specificity.[273]

VII. Legislative Proposal

Because of the current uncertainty in the law, corrective federal legislation should now be enacted.[274] In this process, the many im-

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101(20)(E)(v)).

265. H.R. 1643, 102nd Cong., 1st Sess. (1991).

266. *Id.* § 2.

267. *Id.* § 3.

268. *Id.* § 2(a)(2) (new paragraph 101(20)(E)(IV)).

269. *Id.* 2(a)(2) (new paragraph 101(20)(E)(i)).

270. H.R. 1643, 102nd Cong., 1st Sess. (1991) (new paragraph 101(20)(E)(II)). Another provision of the Owens Proposal would require regulatory agencies to take action to assure that regulated lenders "develop and implement adequate procedures to evaluate potential environmental risks that may arise from or at vessel or facilities subject to their lending activities." *Id.* § 2(c).

271. *Id.* § 2(a)(2) (new paragraph 101(20)(E)(V)).

272. *Id.* § 2(d).

273. *Id.* § 3.

274. Proposed statutory language applicable to CERCLA is set out below. It is also proposed that similar modifications be made to all federal statutes imposing strict liability for the release or threatened release of substances causing damage to the environment:
The Comprehensive Environmental Response Compensation and Liability Act of 1980 (42 U.S.C § 9601-9675) is amended as follows:

(A) 42 U.S.C § 9601(20)(A) is amended by deleting the following language: "Such term does not include any person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility." and by inserting the following in its place: "The term 'owner" does not include any person who holds any indicia of ownership in the vessel or facility primarily to protect his security interest in the vessel or facility as long as that person is not an 'operator' of that vessel

provements accomplished by the EPA in the course of adopting the Final EPA Rule should not be abandoned. Those improvements should be incorporated into new legislation. For example, the corrective legislation should address the liability of all secured lenders rather than focusing on federally regulated lenders.

First, corrective legislation should modify the Security Interest Exemption. In that respect, the legislation should simply eliminate the middle ground now existing between "owner" and "operator" status for lenders participating in the management of the borrower. A lender, who is an "owner" by virtue of holding a security interest in the contaminated property but not an "operator," would be exempt. A lender sufficiently entangled in the borrower's business to be an "operator" would obtain no benefit from the Security Interest Exemption. In short, lenders would be treated in the same manner as any other non-owner.

Additionally, the legislation should clarify the intent of Congress to continue the same treatment for lenders who protect their security interest by foreclosure or the equivalent of foreclosure. The provisions of the Final EPA could expressly be adopted by Congress in order to distinguish a former lender who has now taken on the

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or facility."

(B) 42 U.S.C. § 9601(20)(A) is further amended by adding the following language: "No person shall be deemed to be an 'owner or operator' solely by reason of an interest in the vessel or facility held in a fiduciary capacity."

(C) 42 U.S.C. § 9601(20)(A) is further amended by adding the following language: "No person holding an indicia of ownership in the vessel or facility primarily to protect a security interest and no person holding an unsecured right to payment of a debt from an owner or operator of the vessel or facility shall be deemed to be 'owner or operator' by reason of engaging in the following activities: [insert here the activities specified in section 300.1100(c)(2) of the Final EPA Rule].

(D) 42 U.S.C. § 9601 is amended by adding the following subsections 9601(39), (40) and (41) and (42): [Insert here the text of sections 300.1100(a) and (b) and (d) of the Final EPA Rule].

(E) 42 U.S.C. § 9601(35)(B) is amended by adding the following language: "The appropriate federal supervisory agency for each regulated financial institution shall, after consultation with the Environmental Agency and no later than [insert date], adopt regulations specifying the circumstances under which each regulated financial institution subject to its supervision shall be required to investigate whether a vessel or facility offered by a prospective borrower as security or partial security for a loan by that regulated financial institution has been contaminated by a hazardous substance and specifying the nature of the investigation required. Those regulations shall establish categories of loans based on the likelihood of prior contamination and the nature of the investigation required by those regulations shall vary based on that likelihood. A regulated financial institution which has complied with the regulations applicable to that regulated financial institution in a particular case shall be deemed to have undertaken, for purposes of this subparagraph 35(B), all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice. For purposes of this subparagraph (35)(B), appropriate federal supervisory agency' shall mean [insert names of agencies for various types of institutions] and 'regulated financial institution' [insert definition]".

role of an investor from a lender who has been forced to acquire legal title to protect their security interest.

The Innocent Landowner Defense should also be clarified. First, Congress should place an affirmative duty on all federally supervised financial institutions to obtain environmental audits in connection with environmentally sensitive loans. Second, the standards for the audits would be most effectively established by the banking supervisory agencies in consultation with the EPA. A lender complying with these standards should fall within a safe harbor for purposes of the Innocent Landowner Defense.

Once Congress has enacted these basic structural modifications, it should add two clarifying provisions to the legislation. First, a fiduciary should not have any liability under CERCLA solely because of their status as a fiduciary. Second, a lender, either secured or unsecured, who requires assurance of a borrower's compliance with environmental law should not be liable under CERCLA. In both cases, these clarifications are consistent with the EPA's stated understanding of the current law. Finally, all federal statutes imposing liability on lenders for environmental damage should be treated in a consistent fashion. Therefore, conforming amendments should be made to all such federal statutes.

VIII. Conclusion

The current status of the law of lender liability for hazardous substance cleanup is simply unacceptable. It is unacceptable primarily because of the lack of certainty which lenders face. This uncertainty is in direct conflict with other significant national interests, such as the availability of credit to encourage small business development and improvement of low and moderate income areas of the community.

It is impossible to provide lenders with anything approaching complete certainty. Absent federal preemption, lenders will still face the prospect of state common law and statutory claims. However, it is certainly possible to improve the lending climate by making the federal law of lender liability for hazardous waste cleanup reasonably clear.

The best and most straightforward solution[275] is the elimination of the "participation in management" aspect of the Security Interest

275. *See* Hathaway, *supra* note 238; and Howard and Gerard, *supra* note 2 at 1220, 1229 (advocating an unjust enrichment approach to lender liability which would strike the participation in management language from the Security Interest Exemption).

Exemption. This would eliminate lender liability under federal law for lender actions as a lender. Lenders, as is clearly the case under existing law, would remain liable when taking on an "operator," "arranger," or "transportor" status and would be subject to common law theories such as aiding and abetting as the courts would deem appropriate. In addition, a safe harbor component should be incorporated into the Innocent Landowne Defense. This approach would both encourage environmentally responsible behavior and improve the lending climate.

Even if a lender's liability is more clearly defined and limited by the application of the Final EPA Rule and the enactment of the proposed federal legislation, it is unlikely that that lenders will become careless in assessing environmental risks upon the collateral securing their loans or in the administration of those loans. Lenders will continue to face the business risks that environmental contamination will render the buyer unable to pay and render the collateral less marketable. Lenders will also need to plan for the potential liability arising from state common law and statutory theories of recovery and to meet the proposed "due diligence standards" imposed by their supervisory agencies. Such an approach would achieve a more appropriate balance among competing national interests than the existing structure.